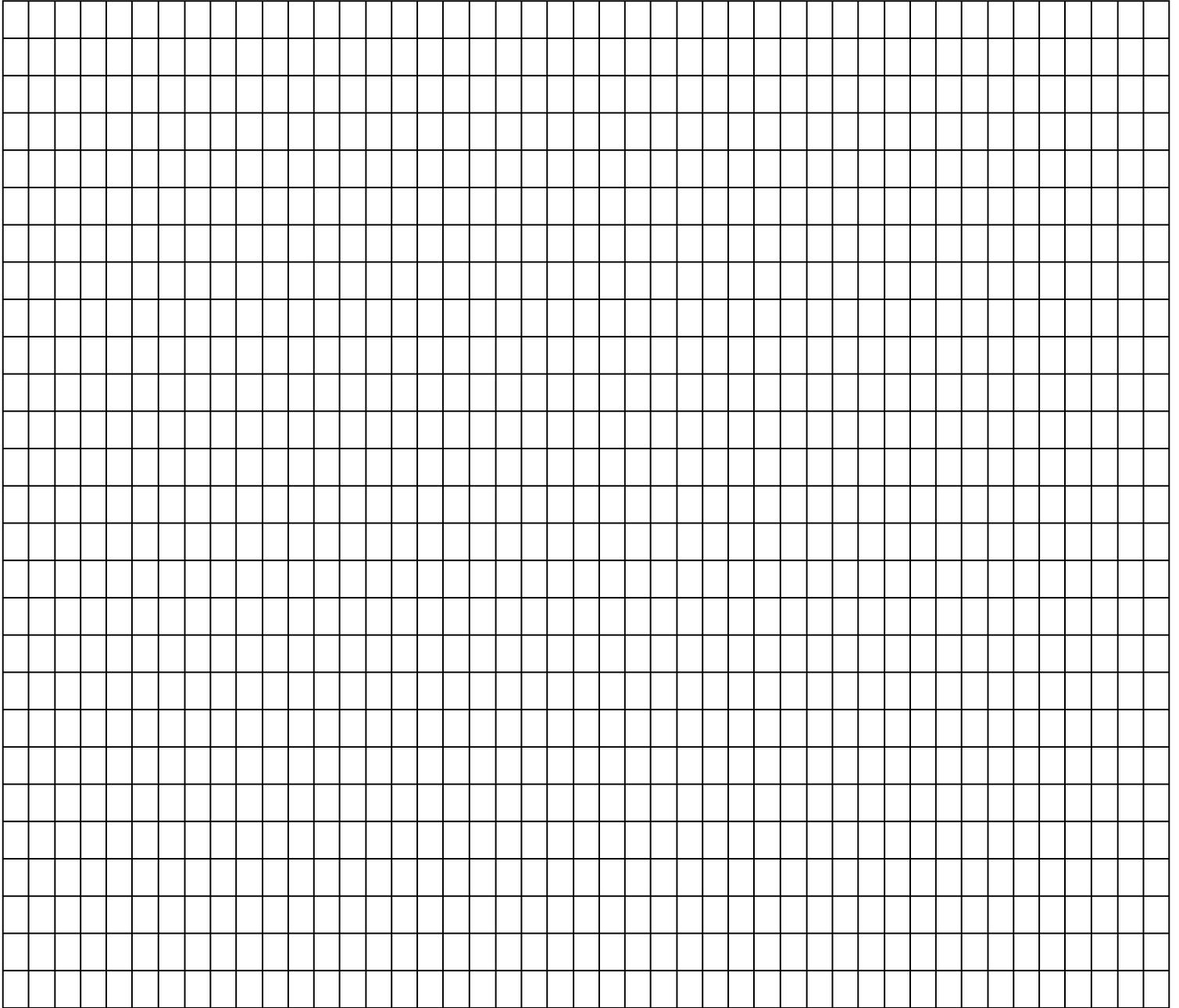


**Joint Operating Agreement:
Working Manual
By
Andrew B. Derman**



INTRODUCTION

To facilitate the drilling of thousands of wells within the United States annually, the oil industry has relied on form agreements. The American Association of Petroleum Landmen has since 1956 provided industry with standardized Joint Operating Agreements. The 1956 form was revised in 1977 and again revised in 1982. The forms have, generally, been effective in establishing procedures and obligations which have resulted in the drilling of tens of thousands of wells with minimal litigation.

This Manual reviews each of the provisions of the Joint Operating Agreement and provides a discussion of that provision with selective comments on how the provision might be strengthened or amended. In addition, the Manual reviews exhibits that are customarily attached to the Joint Operation Agreement.

Article XV. is reserved for additional provisions. I have suggested a number of additional provisions which amend and/or supplement the Joint Operating Agreement.

We live in a dynamic age where rules need to be modified to fit the times. The A.A.P.L. Form Joint Operating Agreement has served the industry well, but as the oil industry evolves so must the form. This Manual seeks to educate the reader as to what the Joint Operating Agreement provides and to offer suggestions on how it can be improved.

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1982 JOINT OPERATING AGREEMENT
WITH COMMENTS

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

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

_____, 19____,

OPERATOR _____

CONTRACT AREA _____

COUNTY OR PARISH OF _____ STATE OF _____

Cover Page - JOA

Date The date inserted should be consistent with the date included in Article XVI., line 9, page 15. As a word of caution, this date should be earlier than the date provided in Article VI.A. If not, it is questionable whether the Operator is obligated to drill the Initial Well. If the Joint Operating Agreement (hereinafter referred to as "JOA") is attached to a farmout agreement or an exploration agreement and will become effective at some future date, the date provisions should be modified accordingly. For example, if the JOA is attached as an exhibit to a farmout and is to be effective after payout and conversion, the date provisions might read, "To be effective if and when Farmor and Farmee become joint owners in any of the Farmout Lands covered by the Farmout Agreement dated _____, 198___ and attached hereto."

Operator : This is the same person named in the body of the Agreement. Be certain to use the proper corporate name.

Contract This is a brief description of lands covered by the Agreement. For example, NW of Section 16, Township 6 North – Range 8 East.
Area : Be certain that the Contract Area description is identical to that described in Exhibit "A". If the description is long and detailed, describe the Contract Area on an Exhibit and include the following reference – "As described on Exhibit 'A' attached hereto."

The parties should carefully consider the size of the Contract Area. A Contract Area that is overly expansive may well contractually bind the parties to jointly develop property years after the initial well is drilled. This can be troublesome where the Contract Area includes unleased acreage. In this situation, an Area of Mutual Interest provision should be included in Article XV. (See Article XV.M. for an example.) An expansive Contract Area combined with the selection of Option No. 1 of Article XIII. can unintentionally create contractual relationships which will endure for decades. A party may find that a nine year old JOA controls operations on a new play on acreage that has never been drilled. Conversely, a Contract Area that is too small may cause difficulties where the exploration or development program includes acreage that is not within the Contract Area. If a

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

MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT

DATED

_____, 19____,

OPERATOR _____

CONTRACT AREA _____

COUNTY OR PARISH OF _____ STATE OF _____

Cover Page - JOA

lessee or a mineral owner refuses to expand the Contract Area or execute another JOA which encompasses this additional acreage, the party desirous of drilling has neither the benefit of a procedure that governs the proposal of a well nor the benefit of the non-consent penalty provisions.

A.A.P.L. FORM 610 - MODEL FORM OPERATING AGREEMENT - 1982

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 profit 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.
13. 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.

Page I - JOA

This page sets forth the basic instructions to be used in completing the form. Carefully follow instruction #6 when amending the form to provide that loss of title shall be a joint loss. This page should be removed after preparation.

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Page II - JOA

The Table of Contents describes the provisions of the Joint Operating Agreement. While not mandatory, it is good practice to delete references to provisions that have been deleted in the body of the Agreement. For example, if the Preferential Right to Purchase provision is deleted in the body of the Agreement, it is advisable to run a conspicuous line through such reference in the Table of Contents.

OPERATING AGREEMENT

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THIS AGREEMENT, entered into by and between _____, hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators".

WITNESSETH:

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

NOW, THEREFORE, it is agreed as follows:

ARTICLE I.
DEFINITIONS

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

- A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.
- B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.
- C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.
- D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".
- E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.
- F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.
- G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.
- H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

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

ARTICLE II.
EXHIBITS

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

- A. Exhibit "A", shall include the following information:
 - (1) Identification of lands subject to this agreement,
 - (2) Restrictions, if any, as to depths, formations, or substances,
 - (3) Percentages or fractional interests of parties to this agreement,
 - (4) Oil and gas leases and/or oil and gas interests subject to this agreement,
 - (5) Addresses of parties for notice purposes.
- ~~B. Exhibit "B", Form of Lease.~~
- C. Exhibit "C", Accounting Procedure.
- D. Exhibit "D", Insurance.
- E. Exhibit "E", Gas Balancing Agreement.
- F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.
- G. Exhibit "G", Tax Partnership.

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

Page 1 - JOA

PREAMBLE

Enter the name of Operator. Remember to use the party's legally correct name. In light of the proliferation of master limited partnerships and other tax motivated entities, it is advisable to include a reference to both the master limited partnership and the operating company. The drafters of the JOA did not anticipate the use of master limited partnerships and their like; consequently, the JOA needs to be somehow hybridized. Since the cover page and Article V.A. only reference the Operator, the Operator's full corporate name is adequate. In the event that a master limited partnership is involved and it is that entity that owns title to the oil and gas leases or oil and gas interests, it is advisable to have both the name of the master limited partnership and the entity that has been designated as Operator in this section, as well as on the signature line and Exhibit "A". The following, for example, may be inserted into lines 3 and 4: "Luckey Oil Company as Managing General Partner of Luckey Oil Operating Limited Partnership."

Article I

Definitions are important. Note that the term "oil and gas" is broadly defined (lines 20-21) and that "oil and gas interests" includes unleased fee and mineral interests (lines 24-25). The definition of the term "oil and gas" includes "all other liquid or gaseous hydrocarbons and other marketable substances produced therewith." Therefore, carbon dioxide which is produced along with any liquid or gaseous hydrocarbons is to be developed and governed by the JOA. However, the JOA as written does not govern the development and production of carbon dioxide that is not produced in conjunction with a liquid or gaseous hydrocarbon. Be aware that Exhibit "A" is referenced on line 28. If Exhibit "A" does not describe the leases within the Contract Area, this line should be deleted. Feel free to define other terms as may be required.

Article II

Check the appropriate boxes to indicate those exhibits that are attached. Frequently, line 51, Exhibit "B", form of lease, will not be attached. To ensure the form is properly completed, it is advisable to run a conspicuous line through a reference to an exhibit which is not attached.

ARTICLE III.
INTERESTS OF PARTIES

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**** 4 A. Oil and Gas Interests:
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6 If any party owns an oil and gas interest in the Contract Area, that interest shall be treated for all purposes of this agreement
7 and during the term hereof as if it were covered by the form of oil and gas lease attached hereto as Exhibit "B", and the owner thereof
8 shall be deemed to own both the royalty interest reserved in such lease and the interest of the lease thereunder.
9

10 B. Interests of Parties in Costs and Production:
11

12 Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and
13 paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties as their interests are set
14 forth in Exhibit "A". In the same manner, the parties shall also own all production of oil and gas from the Contract Area subject to the
**** 15 payment of royalties to the extent of one-eighth (1/8th) which shall be borne as hereinafter set forth.
16

17 Regardless of which party has contributed the lease(s) and/or oil and gas interest(s) hereto on which royalty is due and
18 payable, each party entitled to receive a share of production of oil and gas from the Contract Area shall bear and shall pay or deliver, or
19 cause to be paid or delivered, to the extent of its interest in such production, the royalty amount stipulated hereinabove and shall hold the
20 other parties free from any liability therefor. No party shall ever be responsible, however, on a price basis higher than the price received
21 by such party, to any other party's lessor or royalty owner, and if any such other party's lessor or royalty owner should demand and
22 receive settlement on a higher price basis, the party contributing the affected lease shall bear the additional royalty burden attributable to
23 such higher price.
24

25 Nothing contained in this Article III.B. shall be deemed an assignment or cross-assignment of interests covered hereby.
26

27 C. Excess Royalties, Overriding Royalties and Other Payments:
28

29 Unless changed by other provisions, if the interest of any party in any lease covered hereby is subject to any royalty,
30 overriding royalty, production payment or other burden on production in excess of the amount stipulated in Article III.B., such party so
31 burdened shall assume and alone bear all such excess obligations and shall indemnify and hold the other parties hereto harmless from any
32 and all claims and demands for payment asserted by owners of such excess burden.
33

34 D. Subsequently Created Interests:
35

36 If any party should hereafter create an overriding royalty, production payment or other burden payable out of production
37 attributable to its working interest hereunder, or if such a burden existed prior to this agreement and is not set forth in Exhibit "A", or
38 was not disclosed in writing to all other parties prior to the execution of this agreement by all parties, or is not a jointly acknowledged and
39 accepted obligation of all parties (any such interest being hereinafter referred to as "subsequently created interest" irrespective of the
40 timing of its creation and the party out of whose working interest the subsequently created interest is derived being hereinafter referred
41 to as "burdened party"), and:
42

43 1. If the burdened party is required under this agreement to assign or relinquish to any other party, or parties, all or a portion
44 of its working interest and/or the production attributable thereto, said other party, or parties, shall receive said assignment and/or
45 production free and clear of said subsequently created interest and the burdened party shall indemnify and save said other party,
46 or parties, harmless from any and all claims and demands for payment asserted by owners of the subsequently created interest;
47 and,
48

**** 49 2. If the burdened party fails to pay, when due, its share of expenses chargeable hereunder, all provisions of Article VII.B. shall be
50 enforceable against the subsequently created interest in the same manner as they are enforceable against the working interest of
51 the burdened party.
52

53 ARTICLE IV.
54 TITLES
55

56 A. Title Examination:
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58 Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if
59 the Drilling Parties so request, title examination shall be made on the leases and/or oil and gas interests included, or planned to be included,
60 in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding
61 royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and/or oil and
62 gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including federal lease status
63 reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or
64 made available to Operator by the parties, but necessary for the examination of the title, shall be obtained by Operator. Operator shall
65 cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party
66 hereto. The cost incurred by Operator in this title program shall be borne as follows:
67

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

Article III

A. Oil & Gas Interests

This provision is frequently deleted where the parties to the Agreement do not own unleased oil and gas interests. If this provision is deleted, the relative portions of lines 52 to 55 on page 8 and line 1 on page 9 or lines 48 to 51 on page 8 alternate and line 1 of page 9 and lines 24 to 27 on page 11 should also be deleted. If there is any doubt as to whether a party owns an oil and gas interest, the other parties should insist that this provision be included.

B. Interests of Parties in Costs and Production

Note that "production" is owned as allocated in Exhibit "A". The JOA does not pool revenues. Pursuant to Article VI.C., each party is to take (or separately dispose of) its own share of production. Royalties are likewise not pooled. Each party is responsible for paying its share of the royalty burden. Royalties are borne by each party, based upon its interest and production, and not based upon the ownership of the lease from which the oil and gas is produced. Generally, the blank should be filled in with the smallest royalty contained in the leases contributed to the JOA. If at least one lease contains a 1/8 royalty, complete the blank with the words "one-eighth (1/8th)." By so doing, each party taking production will pay a 1/8 royalty, based upon its share of production. Any additional royalty, override or production payment or other burden in excess of the 1/8th royalty will be paid by the party burdened by such excess obligation. If no party, however, has a 1/8 royalty lease, the blank should be completed to reflect the lowest royalty payable under the terms of any lease.

C. Excess Royalties, Overriding Royalties and Other Payments

The party whose interest is burdened by any amount in excess of the amount stipulated in Article III.B. shall assume and bear all such excess royalties.

D. Subsequently Created Interests

All subsequently created interests as well as those burdens that existed when the JOA was executed but were not disclosed in Exhibit "A" or were not disclosed in writing to all the parties or not jointly acknowledged and accepted shall be assumed by the party creating such interest. Expenses shall be chargeable against the subsequently created interest if the burdened party fails to pay its expenses when due. It is questionable whether the parties can enforce Article III.D.2. against the holder of a subsequently created interest who is a bona fide purchaser for

ARTICLE III.
INTERESTS OF PARTIES

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**** 4 A. Oil and Gas Interests:
5

6 If any party owns an oil and gas interest in the Contract Area, that interest shall be treated for all purposes of this agreement
7 and during the term hereof as if it were covered by the form of oil and gas lease attached hereto as Exhibit "B", and the owner thereof
8 shall be deemed to own both the royalty interest reserved in such lease and the interest of the lease thereunder.
9

10 B. Interests of Parties in Costs and Production:
11

12 Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and
13 paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties as their interests are set
14 forth in Exhibit "A". In the same manner, the parties shall also own all production of oil and gas from the Contract Area subject to the
**** 15 payment of royalties to the extent of one-eighth (1/8th) which shall be borne as hereinafter set forth.
16

17 Regardless of which party has contributed the lease(s) and/or oil and gas interest(s) hereto on which royalty is due and
18 payable, each party entitled to receive a share of production of oil and gas from the Contract Area shall bear and shall pay or deliver, or
19 cause to be paid or delivered, to the extent of its interest in such production, the royalty amount stipulated hereinabove and shall hold the
20 other parties free from any liability therefor. No party shall ever be responsible, however, on a price basis higher than the price received
21 by such party, to any other party's lessor or royalty owner, and if any such other party's lessor or royalty owner should demand and
22 receive settlement on a higher price basis, the party contributing the affected lease shall bear the additional royalty burden attributable to
23 such higher price.
24

25 Nothing contained in this Article III.B. shall be deemed an assignment or cross-assignment of interests covered hereby.
26

27 C. Excess Royalties, Overriding Royalties and Other Payments:
28

29 Unless changed by other provisions, if the interest of any party in any lease covered hereby is subject to any royalty,
30 overriding royalty, production payment or other burden on production in excess of the amount stipulated in Article III.B., such party so
31 burdened shall assume and alone bear all such excess obligations and shall indemnify and hold the other parties hereto harmless from any
32 and all claims and demands for payment asserted by owners of such excess burden.
33

34 D. Subsequently Created Interests:
35

36 If any party should hereafter create an overriding royalty, production payment or other burden payable out of production
37 attributable to its working interest hereunder, or if such a burden existed prior to this agreement and is not set forth in Exhibit "A", or
38 was not disclosed in writing to all other parties prior to the execution of this agreement by all parties, or is not a jointly acknowledged and
39 accepted obligation of all parties (any such interest being hereinafter referred to as "subsequently created interest" irrespective of the
40 timing of its creation and the party out of whose working interest the subsequently created interest is derived being hereinafter referred
41 to as "burdened party"), and:
42

43 1. If the burdened party is required under this agreement to assign or relinquish to any other party, or parties, all or a portion
44 of its working interest and/or the production attributable thereto, said other party, or parties, shall receive said assignment and/or
45 production free and clear of said subsequently created interest and the burdened party shall indemnify and save said other party,
46 or parties, harmless from any and all claims and demands for payment asserted by owners of the subsequently created interest;
47 and,
48

**** 49 2. If the burdened party fails to pay, when due, its share of expenses chargeable hereunder, all provisions of Article VII.B. shall be
50 enforceable against the subsequently created interest in the same manner as they are enforceable against the working interest of
51 the burdened party.
52

53 ARTICLE IV.
54 TITLES
55

56 A. Title Examination:
57

58 Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if
59 the Drilling Parties so request, title examination shall be made on the leases and/or oil and gas interests included, or planned to be included,
60 in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding
61 royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and/or oil and
62 gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including federal lease status
63 reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or
64 made available to Operator by the parties, but necessary for the examination of the title, shall be obtained by Operator. Operator shall
65 cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party
66 hereto. The cost incurred by Operator in this title program shall be borne as follows:
67

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

Page 2 - JOA

Article III

D. Subsequently Created Interests - Continued

value without notice of existence of a JOA. The recording of the JOA or a Memorandum of JOA would put the world on notice of the existence of a JOA and it could be argued that parties who obtained mineral interests subsequent to the effective date of the JOA were on notice of the existence of a JOA and, thus, take their interest subject to Article III.D.2. The recording of the JOA or a Memorandum of JOA would not affect a mineral interest acquired prior to such recording. A party to the JOA likely will only be able to enforce its rights against the burdened party where the owner of the subsequently created interest did not have actual or constructive notice of the existence of the JOA.

Pages 2 and 3 - JOA

Article IV

A. Title Examination

Be advised that unless requested by the Drilling Parties, title examination is limited to the drillsite. Option No. 1 imposes the cost of title examination on the Operator, thus treating the expenses as a part of the administrative overhead. Option No. 2 allocates the costs to the Drilling Parties in the proportion their interest bears to the total interest of all Drilling Parties as such appears in Exhibit "A". Obviously, when you are the Operator, Option No. 2 should be selected. Note that the last paragraph of this sub-article states that no drilling is to commence until title has been examined and approved by the examiner or by all Drilling Parties. On occasion, this provision is amended to provide that Operator can accept title in lieu of acceptance by all the Drilling Parties. Before accepting such a change, when you are Non-Operator, consider the associated risks and implications. By giving the Operator the right to approve title, the Drilling Parties delegate responsibility for title acceptance. If part or all of the title fails and the parties have adopted the individual loss provision, the party whose title failed will, unless he can secure a new lease or cure title within 90 days, have its interest in the Contract Area reduced in the proportion that the acreage related to the title failure bears to the total acreage committed to the JOA. The Operator will likely not be responsible for any title failure, unless the Operator fails to meet the standards set forth in Article V.A. which only imposes liability for losses incurred as a result of its gross negligence or willful misconduct.

ARTICLE IV

continued

***** 1 Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination
 2 (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties
 3 in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in
 4 Exhibit "A". Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above
 5 functions.
 6

7 Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection
 8 with leases or oil and gas interests contributed by such party. Operator shall be responsible for the preparation and recording of pooling
 9 designations or declarations as well as the conduct of hearings before governmental agencies for the securing of spacing or pooling orders.
 10 This shall not prevent any party from appearing on its own behalf at any such hearing.
 11

12 No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above
 13 provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to
 14 participate in the drilling of the well.
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16 B. Loss of Title:
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18 1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss
 19 reduction of interest from that shown on Exhibit "A", the party contributing the affected lease or interest shall have ninety (90) days
 20 from final determination of title failure to acquire a new lease or other instrument curing the entirety of the title failure, which
 21 acquisition will not be subject to Article VIII.B., and failing to do so, this agreement, nevertheless, shall continue in force as to all remaining oil
 22 and gas leases and interests; and,

23 (a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be
 24 entitled to recover from Operator or the other parties any development or operating costs which it may have theretofore paid or incurred,
 25 but there shall be no additional liability on its part to the other parties hereto by reason of such title failure;

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

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

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

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

39 (f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest
 40 claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in
 41 connection therewith.
 42

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

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

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

60 (c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest
 61 lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.
 62

63 3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall be joint losses
 64 and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of
 65 the Contract Area.
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Article IV
(Individual Loss)

B. Loss of Title

As drafted, this provision imposes losses upon the party contributing the lease; thus its name - individual loss. If a lease is lost as a result of failure of title, and the party is unable within 90 days to secure a new lease, Exhibit "A" shall be adjusted to reflect the change of ownership. The party whose title fails is responsible for all development and operating costs which have been paid or incurred. If the well is dry, the party whose title failed cannot recover for any costs paid or incurred up to the time title fails. Consequently, a party with defective title assumes the dry hole risk. If the well is commercially productive, and as a result of the failure of title, one or more Drilling Parties' interest in the Contract Area is increased, the party whose title has failed shall be reimbursed for his unrecovered expenditures with those proceeds that are attributable to the Drilling Parties whose interests have increased, after deducting costs and associated burdens.

A similar result would occur if a lease terminates as a consequence of the failure to pay rentals, shut-in payments, minimum royalty or royalty payments. And as with the failure of title, if a lease is lost as a consequence of the failure to pay rentals, shut-in payments, minimum royalty or royalty payments, and the party who failed to make such payments cannot secure a new lease within 90 days, the interests of the parties shall be revised on an acreage basis, effective as of the date of termination of the lease. This provision also imposes the dry hole risk on the party whose title has failed. If a party's title fails, but he is fortunate to have paid for a well that finds oil or gas, he can recover his unrecovered costs from the proceeds of production. If the title vests in an entity who is not a party to the JOA, that entity may either ratify the JOA or insist that it be treated as a co-tenant.

All other losses are to be shared jointly by the parties, pursuant to Article IV.B.3. Under this provision, if a lease expires at the end of its primary term, there is no adjustment to Exhibit "A" to reflect the fact that a party's lease has terminated and that party's interest is not reduced. Although at first blush this result may seem peculiar, the parties to a JOA should be cognizant of the primary terms of the leases contributed. They can seek to perpetuate any lease by drilling and eventually all the leases will terminate. If one or more leases contain primary terms that will shortly expire, the parties can, and occasionally do provide that upon termination

ARTICLE IV

continued

***** 1 Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination
 2 (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties
 3 in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in
 4 Exhibit "A". Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above
 5 functions.
 6

7 Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection
 8 with leases or oil and gas interests contributed by such party. Operator shall be responsible for the preparation and recording of pooling
 9 designations or declarations as well as the conduct of hearings before governmental agencies for the securing of spacing or pooling orders.
 10 This shall not prevent any party from appearing on its own behalf at any such hearing.
 11

12 No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above
 13 provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to
 14 participate in the drilling of the well.
 15

16 B. Loss of Title:

17
 18 1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a
 19 reduction of interest from that shown on Exhibit "A", the party contributing the affected lease or interest shall have ninety (90) days
 20 from final determination of title failure to acquire a new lease or other instrument curing the entirety of the title failure, which
 21 acquisition will not be subject to Article VIII.B., and failing to do so, this agreement, nevertheless, shall continue in force as to all remaining oil
 22 and gas leases and interests; and,

23 (a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be
 24 entitled to recover from Operator or the other parties any development or operating costs which it may have theretofore paid or incurred,
 25 but there shall be no additional liability on its part to the other parties hereto by reason of such title failure;

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

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

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

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

39 (f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest
 40 claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in
 41 connection therewith.
 42

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

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

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

60 (c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest
 61 lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.
 62

63 3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall be joint losses
 64 and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of
 65 the Contract Area.
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Article IV
(Individual Loss)

B. Loss of Title - Continued

of a specific lease or leases, the interests of the parties shall be adjusted and Exhibit "A" will be revised to reflect the parties proportionate ownership of surface acres within the Contract Area.

ARTICLE IV
continued

***** 1 Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination
2 (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties
3 in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in
4 Exhibit "A". Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above
5 functions.
6

7 Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection
8 with leases or oil and gas interests contributed by such party. Operator shall be responsible for the preparation and recording of pooling
9 designations or declarations as well as the conduct of hearings before governmental agencies for the securing of spacing or pooling orders.
10 This shall not prevent any party from appearing on its own behalf at any such hearing.
11

12 No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above
13 provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to
14 participate in the drilling of the well.
15

16 B. Loss of Title:
17

***** 18 ~~1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a
19 reduction of interest from that shown on Exhibit "A", the party contributing the affected lease or interest shall have ninety (90) days
20 from final determination of title failure to acquire a new lease or other instrument curing the entirety of the title failure, which
21 acquisition will not be subject to Article VIII.B., and failing to do so, this agreement, nevertheless, shall continue in force as to all remaining oil
22 and gas leases and interests; and,~~

23 ~~(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be
24 entitled to recover from Operator or the other parties any development or operating costs which it may have theretofore paid or incurred,
25 but there shall be no additional liability on its part to the other parties hereto by reason of such title failure;~~

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

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

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

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

39 ~~(f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection with the defense of the interest
40 claimed by any party hereto, it being the intention of the parties hereto that each shall defend title to its interest and bear all expenses in
41 connection therewith.
42~~

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

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

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

60 ~~(c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or becomes, the owner of the interest
61 lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.
62~~

***** 63 ~~3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall be joint losses
64 and shall be borne by all parties in proportion to their interests. There shall be no readjustment of interests in the remaining portion of
65 the Contract Area.
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Page 3 - JOA

Article IV
(Joint Loss)

B. Loss of Title

The instructions on page I of the JOA state that to transform the JOA to a Joint Loss Agreement, it is only necessary to:

1. Delete Articles IV.B.1 and IV.B.2.
2. Delete the phrase "other than those set forth in Articles IV.B.1. and IV.B.2 above."
3. In Article VII.E., change the reference at the end of the first grammatical paragraph from "Article VI.B.2." to "Article IV.B.3."
4. Add a concluding sentence to Article X which reads - "All claims or suits involving title to any interest subject to this agreement shall be treated as a claim or suit against all parties hereto."

A Joint Loss Agreement is appropriate where the parties to the Agreement share a common title. Therefore, if, as a result of a farmout or other arrangement, the parties desire to share the risk of loss or no party has any reason to believe that another's title will fail, a Joint Loss provision can be created.

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ARTICLE V.
OPERATOR

A. Designation and Responsibilities of Operator:

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

B. Resignation or Removal of Operator and Selection of Successor: (Insert Recommended Replacement Language)

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

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. The successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A"; provided, however, if an Operator which has been removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

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

D. Drilling Contracts:

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

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

***** On or before the _____ day of _____, 19_____, Operator shall commence the drilling of a well for oil and gas at the following location:

and shall thereafter continue the drilling of the well with due diligence to

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

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

Article V

A. Designation and Responsibilities of Operator

The name of the Operator should be inserted in the blank. There are three things to notice in this short paragraph.

1. Operator "shall conduct and direct and have full control of all operations." The Operator has control over how the operations are conducted, not necessarily which operations should be conducted or terminated.
2. Operator must conduct operations in a "good workmanlike manner."
3. Operator is exonerated from all losses sustained or liabilities incurred, except those losses or liabilities which "may result from gross negligence or willful misconduct." Gross negligence is generally defined as the failure to use even slight care. While courts do not favor such exculpatory clauses, they are enforceable. Texas courts will strictly construe provisions limiting liability to gross negligence and will only enforce provisions which protect a party against his own negligence where the language is clear and unequivocal. In Hamilton v. Texas Oil & Gas Corp., 648 S.W.2d 316 (Tex. Civ. App. El Paso 1982), the court upheld the trial court's ruling that an Operator who moved the drillsite 630 feet without advising the Non-Operators was grossly negligent. Protection could be obtained by using a geological requirement exhibit or some others performance schedule, which explicitly delineates the course of conduct expected. See also Argos Resources, Inc. v. May Petroleum, Inc., 693 S.W.2d 663 (Tex. App. Dallas [5 Dist.] 1985 writ ref'd n.r.e.) where the court found that the failure to send supplemental AFEs was not gross negligence.

The question as to whether an Operator has the right to conduct tests in the face of objections from one or more Non-Operators occasionally arises. Non-Operators on occasion object to specific tests because they believe that there is no need to test and do not want to make the necessary expenditures or they are concerned that the test will damage the well bore. Article V.A. gives the Operator the right to "conduct and direct and have full control of all operations" so long as the Operator conducts such operations in a good and workmanlike manner. Furthermore, the Operator is only liable for losses that result from its gross negligence or its willful misconduct. Article VI.A. requires the Operator to "make reasonable tests of all formations encountered during drilling which give

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ARTICLE V.
OPERATOR

A. Designation and Responsibilities of Operator:

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

B. Resignation or Removal of Operator and Selection of Successor: (Insert Recommended Replacement Language)

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

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. The successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A"; provided, however, if an Operator which has been removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

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

D. Drilling Contracts:

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

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

***** On or before the _____ day of _____, 19_____, Operator shall commence the drilling of a well for oil and gas at the following location:

and shall thereafter continue the drilling of the well with due diligence to

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

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

Article V

A. Designation and Responsibilities of Operator - Continued

indication of containing oil and gas in quantities sufficient to test." Finally, Article VII.D.1. authorizes expenditures for the payment of all necessary "testing." These provisions provide substantial support to buttress an Operator's decision to test. Generally, an Operator can conduct all tests it deems necessary.

B. Resignation or Removal of Operator and Selection of Successor

It is recommended that, when a company is named as Operator and that Company is having or could possibly have financial difficulties, this provision be amended to provide for the automatic removal of Operator in the event Operator becomes insolvent, bankrupt or is placed in receivership. As written, the 1982 form only provides that these events are causes for removal. To avoid a dispute over the removal of an Operator, the following replacement language is recommended:

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

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ARTICLE V.
OPERATOR

A. Designation and Responsibilities of Operator:

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

B. Resignation or Removal of Operator and Selection of Successor: (Insert Recommended Replacement Language)

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

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. The successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A"; provided, however, if an Operator which has been removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of the Operator that was removed.

C. Employees:

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

D. Drilling Contracts:

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

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

***** On or before the _____ day of _____, 19_____, Operator shall commence the drilling of a well for oil and gas at the following location:

and shall thereafter continue the drilling of the well with due diligence to

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

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

Article V

B. Resignation or Removal of Operator and Selection of Successor - Continued

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the affirmative vote of the parties owning a majority interest based on ownership as shown on Exhibit "A". The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of those parties owning a majority interest based on ownership as shown on Exhibit "A", and after excluding the voting interest of the Operator that was removed.

Even if the parties do not agree on the above-recommended revision, it is advisable to modify the language in Article V.B.1. and Article V.B.2. to replace the term "the affirmative vote of two (2) or more parties owning a majority interest" with "the affirmative vote of the parties owning a majority interest."

If a Non-Operator is concerned about the future cost of operation, a change of Operator provision can be incorporated which would give the Operator the option of reducing its charges or resigning.

Article VI

A. Initial Well

Be careful when completing this provision to specify a realistic date for commencing operations on the first well. This provision contractually obligates the Operator to commence a well. To avoid this result, the form language can be deleted and in its place the parties can insert a variation of the following, "To be drilled in accordance with the terms of the Farmout Agreement (or Exploration Agreement) dated _____, between _____ and _____." Alternatively, the word "shall" could be replaced by the word "may." Interestingly, this provision does not provide for a remedy in the event drilling is not timely commenced. Although this provision on its face compels the commencement of

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ARTICLE V.
OPERATOR

A. Designation and Responsibilities of Operator:

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

B. Resignation or Removal of Operator and Selection of Successor: (Insert Recommended Replacement Language)

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

ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

***** On or before the _____ day of _____, 19_____, Operator shall commence the drilling of a well for oil and gas at the following location:

and shall thereafter continue the drilling of the well with due diligence to

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

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

Article VI

A. Initial Well - Continued

operations by a specified date, the court in Argos Resources, Inc. v. May Petroleum Inc., 693 S.W.2d 663, 664-65 (Tex. App.-Dallas [5th Dist.] 1985, writ ref'd n.r.e.), held that a "clause in a contract which stated that May was to begin drilling on or before December 31, 1981, would have had the effect of a condition precedent only if time has been the essence." And the court further ruled that "time is not necessarily of the essence in an oilfield operating agreement." Although Argos may well not be followed by other courts, if the term of a lease or a farmout is predicated upon the timely commencement of drilling operations, it may be prudent for the parties to add a provision which mandates the commencement of drilling by a specific date and imposes actual damages, liquidated damages or specific performance for failure to perform. See Frankfort Oil Co. v. Snakard, 279 F.2d 436 (10th Cir. 1960) where the court held that the Operator had no obligation to commence operations where the Non-Operator elected not to participate. The court in dicta appeared to suggest that if all the parties elected to participate, the Operator was required to drill within 90 days after expiration of the notice period.

Subsequent operations are governed by Article VI.B. Article VI.B.1. explicitly states that written notice of a proposed operation shall be given if any party desires "to drill any well on the Contract Area other than the well provided in Article VI.A. . . ." If the well is not actually commenced within 90 days after expiration of the notice period, or as promptly as possible when a drilling rig is on location, a new proposal must be resubmitted for approval. The Operator is not obligated to commence operations; however, if he does wish to drill, he must do so within this 90 day (or 48 hour) period.

Under specified circumstances, the Operator can extend this period for an additional 30 days. Although the wording is not explicit, it is implicit that the 30 day extension applies when a drilling rig is not on location and that the Operator can only seek one 30 day extension.

Describe the exact location of the well. Finally, when completing the blank on lines 61 to 64, be sure to specify a depth in feet or a particular formation, whichever is the lesser depth.

Note that Operator is obligated to make reasonable tests of all formations encountered during drilling which give indication of containing oil and or gas in quantities sufficient to test. See

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ARTICLE V.
OPERATOR

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B. Resignation or Removal of Operator and Selection of Successor: (Insert Recommended Replacement Language)

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ARTICLE VI.
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the _____ day of _____, 19_____, Operator shall commence the drilling of a well for oil and gas at the following location:

and shall thereafter continue the drilling of the well with due diligence to

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

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

Article VI

A. Initial Well - Continued

also Article III.A. and Article V.A. Before a well can be plugged and abandoned, all parties must approve of the operation.

This provision does not permit an Operator to terminate drilling, unless all drilling parties consent to such termination. If prior to commencement of the well a party wishes to limit its exposure, it could suggest incorporation of a provision which would permit termination before reaching total depth on the occurrence of a specified event or a specific voting interest, subject to the right of a party(s) to take over the well and bear all future expenses.

ARTICLE VI

continued

1 If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the
2 well as a dry hole, the provisions of Article VI.E.1. shall thereafter apply.

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6 B. Subsequent Operations:

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8 1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area other than the well provided
9 for in Article VI.A., or to rework, deepen or plug back a dry hole drilled at the joint expense of all parties or a well jointly owned by all
10 the parties and not then producing in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the
11 other parties written notice of the proposed operation, specifying the work to be performed, the location, proposed depth, objective
12 formation and the estimated cost of the operation. The parties receiving such a notice shall have thirty (30) days after receipt of the notice
13 within which to notify the party wishing to do the work whether they elect to participate in the cost of the proposed operation. If a
14 drilling rig is on location, notice of a proposal to rework, plug back or drill deeper may be given by telephone and the response period shall be
15 limited to forty-eight (48) hours, exclusive of Saturday, Sunday and legal holidays. Failure of a party receiving such notice to reply within
16 the period above fixed shall constitute an election by that party not to participate in the cost of the proposed operation. Any notice or
17 response given by telephone shall be promptly confirmed in writing.

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21 If all parties elect to participate in such a proposed operation, Operator shall, within ninety (90) days after expiration of the notice
22 period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period when a drilling rig is on
23 location, as the case may be), actually commence the proposed operation and complete it with due diligence at the risk and expense of all
24 parties hereto; provided, however, said commencement date may be extended upon written notice of same by Operator to the other parties,
25 for a period of up to thirty (30) additional days if, in the sole opinion of Operator, such additional time is reasonably necessary to obtain
26 permits from governmental authorities, surface rights (including rights-of-way) or appropriate drilling equipment, or to complete title
27 examination or curative matter required for title approval or acceptance. Notwithstanding the force majeure provisions of Article XI, if the
28 actual operation has not been commenced within the time provided (including any extension thereof as specifically permitted herein) and
29 if any party hereto still desires to conduct said operation, written notice proposing same must be resubmitted to the other parties in
30 accordance with the provisions hereof as if no prior proposal had been made.

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34 2. Operations by Less than All Parties: If any party receiving such notice as provided in Article VI.B.1. or VII.D.1. (Option
35 No. 2) elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this Article, the party or parties
36 giving the notice and such other parties as shall elect to participate in the operation shall, within ninety (90) days after the expiration of
37 the notice period of thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period when a drilling rig is
38 on location, as the case may be) actually commence the proposed operation and complete it with due diligence. Operator shall perform all
39 work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is
40 a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed
41 operation for the account of the Consenting Parties, or (b) designate one (1) of the Consenting Parties as Operator to perform such work.
42 Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and
43 conditions of this agreement.

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47 If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable
48 notice period, shall advise the Consenting Parties of the total interest of the parties approving such operation and its recommendation as
49 to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours
50 (exclusive of Saturday, Sunday and legal holidays) after receipt of such notice, shall advise the proposing party of its desire to (a) limit
51 participation to such party's interest as shown on Exhibit "A" or (b) carry its proportionate part of Non-Consenting Parties' interests, and
52 failure to advise the proposing party shall be deemed an election under (a). In the event a drilling rig is on location, the time permitted for
53 such a response shall not exceed a total of forty-eight (48) hours (inclusive of Saturday, Sunday and legal holidays). The proposing party,
54 at its election, may withdraw such proposal if there is insufficient participation and shall promptly notify all parties of such decision.

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58 The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in the proportions they have
59 elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such
60 operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties.
61 If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well and restore the surface location at their
62 sole cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions of this Article results in a
63 producer of oil and/or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and risk,
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Article VI

B. Subsequent Operations

This provision establishes the procedure for subsequent operations. Be cognizant of changes to the notice periods that are unreasonable. Occasionally, the 48 hour period is modified to read 24 hours (inclusive of Saturday, Sunday and legal holidays). If such a change is made, it is advisable to include a weekend notice phone number and address. Article VI.B. should be carefully reviewed and followed whenever a party wishes to drill any well other than the well provided for in Article IV.A. or wishes to redrill, deepen or plug back a dry hole or complete a well in accordance with Article VII.D. 1. (Option No. 2.)

The obligations created by this provision are comparable to the rights and obligations of co-tenants who drill one or more wells on jointly owned property without the benefits of a JOA. Any co-tenant has the right to enter its land to drill for and produce oil and or gas without the consent of the other co-tenants, subject to the general rule that a co-tenant cannot exclude or deny another co-tenant the right to enter onto the land. Although not without dispute, it has generally been thought that there is no fiduciary relationship among co-tenants solely by virtue of their co-ownership. Lane & Boggs, Duties of Operator or Manager to Its Joint Ventures, 29 Rocky Mt. Min. L. Inst. 199 (1983); Erisman & Dalton, Multi-Party Ownership of Minerals - Real Property Consequences of Joint Mineral Development, 25 Rocky Mt. Min. L. Inst. 7-1 (1979); Bledsoe, Selected Creditor Problems - Joint Interest Operations, 23rd Ann. Inst. on Oil & Gas L. & Tax'n 215 (1972).

Two notes of caution are offered with regard to this provision. First, nothing in this Article restricts the number of wells that can be proposed. A Party could conceivably propose the drilling of twenty or more wells. The only limitation is that the well need be spud within 90 days of the expiration of the notice period or as soon as possible if a drilling rig is on location. To eliminate the potential for this dilemma, a provision is occasionally added which provides that only one well may be proposed at a time. (See Article XV.L. for an example.) Second, Article VI.B.1. does not provide a procedure to resolve differing proposals. Apparently, the proposals are to be considered on a first-come first-serve basis. The parties could avoid this potential problem by adopting a procedure which requires an affirmative vote of the working interest owners who own a majority of the interest in the Contract Area before undertaking any operation. This is generally not a problem because the Operator usually owns the greatest interest and it is the Operator who normally proposes specific operations. In addition, disputes have arisen where the parties disagree over

ARTICLE VI

continued

1 and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting
 2 Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties
 3 in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties,
 4 and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting
 5 Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or
 6 market value thereof if such share is not sold, (after deducting production taxes, excise taxes, royalty, overriding royalty and other
 7 interests not excepted by Article III.D. payable out of or measured by the production from such well accruing with respect to such interest
 8 until it reverts) shall equal the total of the following:
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 12 ***** (a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead
 13 connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such
 14 Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-
 15 Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-
 16 Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to such Non-Consenting
 17 Party had it participated in the well from the beginning of the operations; and
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19
 20
 21 ***** (b) _____ % of that portion of the costs and expenses of drilling, reworking, deepening, plugging back, testing and completing,
 22 after deducting any cash contributions received under Article VIII.C., and _____% of that portion of the cost of newly acquired
 23 equipment in the well (to and including the wellhead connections), which would have been chargeable to such Non-Consenting Party if it had
 24 participated therein.
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 27
 28 An election not to participate in the drilling or the deepening of a well shall be deemed an election not to participate in any re-
 29 working or plugging back operation proposed in such a well, or portion thereof, to which the initial Non-Consent election applied that is
 30 conducted at any time prior to full recovery by the Consenting Parties of the Non-Consenting Party's recoupment account. Any such
 31 reworking or plugging back operation conducted during the recoupment period shall be deemed part of the cost of operation of said well
 32 and there shall be added to the sums to be recouped by the Consenting Parties one hundred percent (100%) of that portion of the costs of
 33 the reworking or plugging back operation which would have been chargeable to such Non-Consenting Party had it participated therein. If
 34 such a reworking or plugging back operation is proposed during such recoupment period, the provisions of this Article VI.B. shall be
 35 applicable as between said Consenting Parties in said well.
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 39 During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the
 40 proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, excise, gathering and other
 41 taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production not excepted by
 42 Article III.D.
 43

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 45
 46 In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free
 47 of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon
 48 abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such
 49 equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.
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 52
 53 Within sixty (60) days after the completion of any operation under this Article, the party conducting the operations for the
 54 Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an
 55 itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its
 56 option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly
 57 billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the party conducting the
 58 operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities
 59 incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds
 60 realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas
 61 ***** produced during any month, Consenting Parties shall use ~~industry accepted methods such as, but not limited to, metering or periodic~~
 62 ~~well tests~~. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation
 63 which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs
 64 of the work done and of the equipment purchased in determining when the interest of such Non-Consenting Party shall revert to it as
 65 above provided; and if there is a credit balance, it shall be paid to such Non-Consenting Party.
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Article VI

B. Subsequent Operations - Continued

the merits of drilling a shallow or a deep test. This is especially problematic where certain parties may only own the shallow or deep rights and is further exacerbated by the recent introduction of forfeiture clauses. To remedy this potential conflict, a provision could be added which permits separate elections as to the shallow and deep horizons with non-consent provisions tailored to consider whether the horizon is developmental or exploratory. In addition, the parties need to consider the priorities for testing and development.

The JOA provides for an orderly development by setting forth procedures and establishing deadlines and time tables. In addition, Article VI.B. establishes non-consent penalties. If a co-tenant successfully finds production, he must account to its co-tenants for net production or the fair market value of the co-tenants' share of the oil and gas produced after deducting its reasonable cost of producing and marketing. In some states, including Texas, the recovery of costs is limited to only 100 percent and does not permit recoupment of dry hole expenses. Other states have statutorily provided for a specified recovery in excess of the amount expended.

The non-consent penalty provisions provide necessary incentives to encourage development where less than all the co-tenants wish to develop jointly held property. It is common to provide for a 100%-300% non-consent penalty (by leaving line 12 unchanged and by inserting 300% in the blank on line 21); however, these figures should be determined on a deal-by-deal basis. A 100%-300% non-consent penalty gives the Consenting Parties the right to recover 100% of their costs for all newly acquired surface equipment beyond the wellhead connections and 100% of the cost of operation. In addition, the Consenting Parties shall recover 300% of the cost of drilling, reworking, deepening, plugging back, testing and completing and 300% of all newly acquired equipment in the well. This provision permits the Consenting Parties to recover 100% of all costs that are avoidable or without risk and to encourage risk taking, gives those that expend risk dollars a return on their investment, usually 300%. Occasionally, in particularly risky areas, the non-consent penalties may be increased. The 100% figure is sometimes increased to 150% or 200%, even though this increase bears little correlation to the assumption of risk. The 300% figure which is directly related to the assumption of risk is occasionally increased to 500% and in rare situations, it has been increased as high as 800%. If a party to the JOA wants to encourage the other parties to the JOA to participate in a

ARTICLE VI

continued

1 and the well shall then be turned over to Operator and shall be operated by it at the expense and for the account of the Consenting
 2 Parties. Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such well by Consenting Parties
 3 in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties,
 4 and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting
 5 Party's interest in the well and share of production therefrom until the proceeds of the sale of such share, calculated at the well, or
 6 market value thereof if such share is not sold, (after deducting production taxes, excise taxes, royalty, overriding royalty and other
 7 interests not excepted by Article III.D. payable out of or measured by the production from such well accruing with respect to such interest
 8 until it reverts) shall equal the total of the following:
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 12 ***** (a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface equipment beyond the wellhead
 13 connections (including, but not limited to, stock tanks, separators, treaters, pumping equipment and piping), plus 100% of each such
 14 Non-Consenting Party's share of the cost of operation of the well commencing with first production and continuing until each such Non-
 15 Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-
 16 Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to such Non-Consenting
 17 Party had it participated in the well from the beginning of the operations; and
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 21 ***** (b) _____ % of that portion of the costs and expenses of drilling, reworking, deepening, plugging back, testing and completing,
 22 after deducting any cash contributions received under Article VIII.C., and _____% of that portion of the cost of newly acquired
 23 equipment in the well (to and including the wellhead connections), which would have been chargeable to such Non-Consenting Party if it had
 24 participated therein.
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26
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 28 An election not to participate in the drilling or the deepening of a well shall be deemed an election not to participate in any re-
 29 working or plugging back operation proposed in such a well, or portion thereof, to which the initial Non-Consent election applied that is
 30 conducted at any time prior to full recovery by the Consenting Parties of the Non-Consenting Party's recoupment account. Any such
 31 reworking or plugging back operation conducted during the recoupment period shall be deemed part of the cost of operation of said well
 32 and there shall be added to the sums to be recouped by the Consenting Parties one hundred percent (100%) of that portion of the costs of
 33 the reworking or plugging back operation which would have been chargeable to such Non-Consenting Party had it participated therein. If
 34 such a reworking or plugging back operation is proposed during such recoupment period, the provisions of this Article VI.B. shall be
 35 applicable as between said Consenting Parties in said well.
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 39 During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the
 40 proceeds therefrom, Consenting Parties shall be responsible for the payment of all production, severance, excise, gathering and other
 41 taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production not excepted by
 42 Article III.D.
 43

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 45
 46 In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall be permitted to use, free
 47 of cost, all casing, tubing and other equipment in the well, but the ownership of all such equipment shall remain unchanged; and upon
 48 abandonment of a well after such reworking, plugging back or deeper drilling, the Consenting Parties shall account for all such
 49 equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.
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 52
 53 Within sixty (60) days after the completion of any operation under this Article, the party conducting the operations for the
 54 Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an
 55 itemized statement of the cost of drilling, deepening, plugging back, testing, completing, and equipping the well for production; or, at its
 56 option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly
 57 billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the party conducting the
 58 operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities
 59 incurred in the operation of the well, together with a statement of the quantity of oil and gas produced from it and the amount of proceeds
 60 realized from the sale of the well's working interest production during the preceding month. In determining the quantity of oil and gas
 61 ***** produced during any month, Consenting Parties shall use ~~industry accepted methods such as, but not limited to, metering or periodic~~
 62 ~~well tests~~. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation
 63 which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unreturned costs
 64 of the work done and of the equipment purchased in determining when the interest of such Non-Consenting Party shall revert to it as
 65 above provided; and if there is a credit balance, it shall be paid to such Non-Consenting Party.
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Pages 5, 6, and 7 - JOA

Article VI

B. Subsequent Operations - Continued

proposed operation, that party will seek to include a high non-consent penalty.

Under certain circumstances, the parties may want to delete Article VI.B.2.(b) and incorporate an obligatory well or blackout provision in Article XV which would operate to deny a non-consenting party any right to the well and the surrounding acreage. (See Articles XV.E., XV.F. and XV.G. for examples.)

It is recommended that the words "industry accepted methods such as, but not limited to" and "or periodic well tests" on lines 61 and 62, page 6 be deleted. Metering is commonly used and is a more accurate tool to determine the quantity of production.

ARTICLE VI

continued

1 If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts 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.

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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.

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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.I. (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
19 production, ceases to produce in paying quantities.

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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
31 Parties.

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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:

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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.

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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 salvable 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.

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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
60 party'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
61 instances the response period to a proposal for sidetracking shall be limited to thirty (30) days.

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65 C. TAKING PRODUCTION IN KIND:

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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~~

Pages 7 and 8 - JOA

Article VI

C. Taking Production in Kind

It is recommended that the last sentence on page 7 that continues over to page 8 be deleted. This sentence states that "[A]ny party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses." It is administratively difficult to ascertain who is using what part of the surface facilities, where one or more parties is taking its production in kind. This presents special problems where a party intermittently takes its production in kind or where a party only takes part of its production in kind. Surface facilities are available to be used by all the parties and it is expedient to allocate the cost of surface facilities in proportion to a party's interest. As currently worded, a party is only required to pay for the proportionate part of the surface facilities that it uses. Although parties are only required to pay for the surface facilities they use, Operators frequently charge the parties for surface equipment in proportion to the party's interest in the JOA, whether or not a party is using a specific piece of surface equipment.

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. *and shall account to such party for the actual net proceeds received
15 for such production, if sold, or the current market price if purchased by Operator.

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 of 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
29 requests the information. Notwithstanding anything to the contrary, a Non-Operator who is in
30 default under Article VII.B shall have no rights under this Article VI.D.

31 E. 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
52 interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and
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
54 intervals 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
55 produced from the interval or intervals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit
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Article VI

C. Taking Production in Kind - Continued

It is advisable to delete the language on lines 9 and 10 which reads "for the account of the non-taking party at the best price obtainable in the area for such production." This language can be construed as imposing a fiduciary duty on Operator to always sell a non-taking party's production at the highest or best price in the area. This is not always possible. It is inequitable to require a party to pay a higher price than the price it receives. Substitute for the deleted language "and shall account to such party for the actual net proceeds received for such production, if sold, or the current market price if purchased by Operator."

For antitrust and tax reasons, the Operator, even if it has the permission of the Non-Operator, is only able to buy or sell the Non-Operator's oil for a limited period of time. An agreement which is for a duration in excess of one year could arguably run afoul of the antitrust laws or could be used by the Internal Revenue Service to support its contention that the parties had a joint profit motive, which could result in taxing the parties to a JOA as partners. Although not without doubt, it is generally assumed that parties can renew the buy/sell arrangement, so long as no single agreement exceeds one year and the owner of production has the right to take in kind.

Another interesting question involves the sale to a subsidiary of the Operator. See Texas Oil & Gas Corp. v. Hagen, 683 S.W. 2d 24 (Tex. App. [6th Dist.] 1985, no writ) (citing Gentry v. Credit Plan Corp. of Houston, 528 S.W.2d 571 (Tex. 1975); Bell Oil & Gas Co. v. Allied Chem. Corp., 431 S.W.2d 336 (Tex. 1968)). Sales to subsidiaries, especially wholly owned subsidiaries of the Operator could be construed as violating the literal language of this provision if such sale is for a period in excess of one year. Although such a literal interpretation could well prohibit such arrangements, the intent and purpose of this Article VI.C. should not limit the ability of a Non-Operator to enter into a sales contract with a subsidiary of an Operator. This page is used when a Gas Balancing Agreement is included. (For a further discussion, see the analysis on Gas Balancing Agreements, Exhibit "E" to the JOA.)

D. Access to Contract Area and Information

As written, a Non-Operator who has failed to pay its invoices and who is thus in default, is still able to obtain well information. To modify this result, the following concluding sentence could be added: "Notwithstanding anything to the contrary, a Non-Operator who is in default under Article VII.B.

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. *and shall account to such party for the actual net proceeds received
 15 for such production, if sold, or the current market price if purchased by Operator.
 16

17 In the event one or more parties' separate disposition of its share of the gas causes split-stream deliveries to separate pipelines and/or
 18 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
 19 be allocated to it, the balancing or accounting between the respective accounts of the parties shall be in accordance with any gas balancing
 20 agreement between the parties hereto, whether such an agreement is attached as Exhibit "E", or is a separate agreement.
 21

22 D. Access to Contract Area and Information:

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 of 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
 29 requests the information. Notwithstanding anything to the contrary, a Non-Operator who is in
 30 default under Article VII.B shall have no rights under this Article VI.D.
 31

32 E. Abandonment of Wells:

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
 52 interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and
 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
 54 intervals 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
 55 produced from the interval or intervals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit
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Article VI

D. Access to Contract Area and Information - Continued

shall have no rights under this Article VI.D." To accommodate a party who is concerned that this addition could be triggered if it has a legitimate objection to part or all of the expenses charged by the Operator, the sentence could be revised to read: "Notwithstanding anything to the contrary, a Non-Operator who is in default under Article VII.B. and who refuses to deposit the disputed amount in escrow pending a resolution of the dispute shall have no rights under this Article VI.D." This addition could further be expanded to read "Notwithstanding anything to the contrary, a Non-Operator who is in default under Article VII.B. or a party who elects not to participate in a proposed operation in accordance with Article VI.B. shall have no rights under this Article VI.D." This revision would deny a non-consenting party the benefits of Article VI.D. Non-consenting parties, when confronted with this revision, might well find such a revision inequitable. They could argue that they have an interest in the well and should have the right to such information. Similarly, a defaulting party could argue that it too has an interest in the well and that it will pay the agreed upon interest and should have the benefits of Article VI.D.

E. Abandonment of Wells

Under this provision, no well shall be plugged and abandoned unless all those parties with an interest in the well consent to such operation.

If the parties to the Agreement do not own unleased oil and gas interests, delete the reference thereto on lines 52 to 55 on page 8 and on line 1 of page 9.

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 and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it,
**** 9 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-~~
10 ~~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
11 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
12 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
13 reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event
14 for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate
15 commerce, of any other party's share of gas production without first giving such other party thirty (30) days notice of such intended sale.
16 *and shall account to such party for the actual net proceeds received for such
17 production, if sold, or the current market price if purchased by Operator.

18 D. Access to Contract Area and Information:

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 gauge and run tickets and reports of stock on hand at the first 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. Notwithstanding anything to the contrary, a Non-Operator who is
26 in default under Article VII.B shall have no rights under this Article VI.D.

27 E. Abandonment of Wells:

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 2. Abandonment of Wells that have Produced: Except for any well in which a Non-Consent operation has been conducted
39 hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has been completed as a
40 producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall
41 be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within
42 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,
43 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
44 parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of
45 Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign
46 the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and
47 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,
**** 48 the interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and
49 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
50 intervals 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
51 produced from the interval or intervals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit
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Article VI

C. Taking Production in-Kind

It is advisable to delete the language on lines 9 and 10 which reads "for the account of the non-taking party at the best price obtainable in the area for such production." This language can be construed as imposing a fiduciary duty on Operator to always sell a non-taking party's production at the highest or best price in the area. This is not always possible. It is inequitable to require a party to pay a higher price than the price it receives. Substitute for the deleted language "and shall account to such party for the actual net proceeds received for such production, if sold, or the current market price if purchased by Operator."

For antitrust and tax reasons, the Operator, even if it has the permission of the Non-Operator, is only able to buy or sell the Non-Operator's oil and gas for a limited period of time. An agreement which is for a duration in excess of one year could arguably run afoul of the antitrust laws or could be used by the Internal Revenue Service to support its contention that the parties had a joint profit motive, which could result in taxing the parties to a JOA as partners. Although not without doubt, it is generally assumed that parties can renew the buy/sell arrangement, so long as no single agreement exceeds one year and the owner of production has the right to take in kind.

Another interesting question involves the sale to a subsidiary of the Operator. See Texas Oil & Gas Corp. v. Hagen, 683 S.W. 2d 24 (Tex. App. [6th Dist.] 1985, no writ) (citing Gentry v. Credit Plan Corp. of Houston, 528 S.W.2d 571 (Tex. 1975); Bell Oil & Gas Co. v. Allied Chem. Corp., 431 S.W.2d 336 (Tex. 1968)). Sales to subsidiaries, especially wholly owned subsidiaries of the Operator could be construed as violating the literal language of this provision if such sale is for a period in excess of one year. Although such a literal interpretation could well prohibit such arrangements, the intent and purpose of this Article VI.C. should not limit the ability of a Non-Operator to enter into a sales contract with a subsidiary of an Operator. This page is used when a Gas Balancing Agreement is not included. Page 8 alternate does no more than give the Operator the right, subject to revocation by the owner of the production, to purchase or sell both oil and gas. Page 8 limits the Operator's right to only purchase or sell oil. (For a further discussion, see the analysis on Gas Balancing Agreements, Exhibit "E" to the JOA.)

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 and gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it,
**** 9 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-~~
10 ~~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
11 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
12 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
13 reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances, but in no event
14 for a period in excess of one (1) year. Notwithstanding the foregoing, Operator shall not make a sale, including one into interstate
15 commerce, of any other party's share of gas production without first giving such other party thirty (30) days notice of such intended sale.
16 *and shall account to such party for the actual net proceeds received for such
17 production, if sold, or the current market price if purchased by Operator.
18

D. Access to Contract Area and Information:

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 gauge and run tickets and reports of stock on hand at the first 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. Notwithstanding anything to the contrary, a Non-Operator who is
26 in default under Article VII.B shall have no rights under this Article VI.D.
27

E. Abandonment of Wells:

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 2. Abandonment of Wells that have Produced: Except for any well in which a Non-Consent operation has been conducted
39 hereunder for which the Consenting Parties have not been fully reimbursed as herein provided, any well which has been completed as a
40 producer shall not be plugged and abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall
41 be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of all the parties hereto. If, within
42 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,
43 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
44 parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of
45 Exhibit "C", less the estimated cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall assign
46 the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and
47 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
**** 48 interval or intervals of the formation or formations then open to production. If the interest of the abandoning party is or includes an oil and
49 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
50 intervals 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
51 produced from the interval or intervals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit
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Article VI

D. Access to Contract Area and Information

As written, a Non-Operator who has failed to pay its invoices and who is thus in default, is still able to obtain well information. To modify this result, the following concluding sentence could be added: "Notwithstanding anything to the contrary, a Non-Operator who is in default under Article VII.B. shall have no rights under this Article VI.D." To accommodate a party who is concerned that this addition could be triggered if it has a legitimate objection to part or all of the expenses charged by the Operator, the sentence could be revised to read: "Notwithstanding anything to the contrary, a Non-Operator who is in default under Article VII.B. and who refuses to deposit the disputed amount in escrow pending a resolution of the dispute shall have no rights under this Article VI.D." This addition could further be expanded to read "Notwithstanding anything to the contrary, a Non-Operator who is in default under Article VII.B. or a party who elects not to participate in a proposed operation in accordance with Article VI.B. shall have no rights under this Article VI.D." This revision would deny a non-consenting party the benefits of Article VI.D. Non-consenting parties, when confronted with this revision, might well find such a revision inequitable. They could argue that they have an interest in the well and should have the right to such information. Similarly, a defaulting party could argue that it too has an interest in the well and that it will pay the agreed upon interest and should have the benefits of Article VI.D.

E. Abandonment of Wells

Under this provision, no well shall be plugged and abandoned unless all those parties with an interest in the well consent to such operation.

If the parties to the Agreement do not own unleased oil and gas interests, delete the reference thereto on lines 52 to 55 on page 8 and on line 1 of page 9.

ARTICLE VI

continued

**** 1 "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the
 2 assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentage of participation in the
 3 Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of
 4 interests in the remaining portion of the Contract Area.
 5

6 Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from
 7 the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon re-
 8 quest, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges con-
 9 templated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned
 10 well. Upon proposed abandonment of the producing interval(s) assigned or leased, the assignor or lessor shall then have the option to
 11 repurchase its prior interest in the well (using the same valuation formula) and participate in further operations therein subject to the pro-
 12 visions hereof.
 13

14 3. Abandonment of Non-Consent Operations: The provisions of Article VI.E.1. or VI.E.2. above shall be applicable as between
 15 Consenting Parties in the event of the proposed abandonment of any well excepted from said Articles; provided, however, no well shall be
 16 permanently plugged and abandoned unless and until all parties having the right to conduct further operations therein have been notified
 17 of the proposed abandonment and afforded the opportunity to elect to take over the well in accordance with the provisions of this Article
 18 VI.E.
 19

ARTICLE VII.

EXPENDITURES AND LIABILITY OF PARTIES

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 23 A. Liability of Parties:
 24

25 The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and
 26 shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted
 27 among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor
 28 shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.
 29

30 B. Liens and Payment Defaults:
 31

32 Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share
 33 of oil and/or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon
 34 at the rate provided in Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the
 35 state, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the ob-
 36 taining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien
 37 rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share
 38 of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from
 39 the sale of such Non-Operator's share of oil and/or gas until the amount owed by such Non-Operator, plus interest, has been paid. Each
 40 purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien
 41 and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.
 42

43 If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by
 44 Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that
 45 the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain
 46 reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.
 47

48 C. Payments and Accounting:
 49

50 Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development
 51 and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective propor-
 52 tionate shares upon the expense basis provided in Exhibit "C". Operator shall keep an accurate record of the joint account hereunder,
 53 showing expenses incurred and charges and credits made and received.
 54

55 Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance
 56 of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding
 57 month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together
 58 with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted
 59 on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within
 60 fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount
 61 due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual ex-
 62 pense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.
 63

64 D. Limitation of Expenditures:
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66 1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened
 67 pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling or deepening shall include:
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Article VII

A. Liability of Parties

In accordance with this provision, the liability of the parties for costs of operations is several, not joint, and this provision explicitly disclaims any intent to create a partnership. A mining partnership is created where co-owners unite to operate the property and share any profits earned. Such a mining partnership may be imposed by law even if the parties explicitly agree in writing not to create a mining partnership. Courts have found that a mining partnership exists where each party to a JOA has the requisite "mutual control" or "active participation" in operations. Dresser Industries, Inc. v. Crystal Exploration and Production Co., No. 83-1275-W (D. Okla. January 17, 1984), aff'd., No. 84-1160 (10th Cir. July 12, 1985). But see Frontier Exploration, Inc. v. Blocker Exploration Company, 709 P.2d 39 (Colo. App. June 6, 1985), cert. pending, where the court held that the requisite "active participation in control or management" did not exist where in accordance with the JOA the Non-Operator received well reports, had access to the drillsite and approved specified operations and expenditures. Any party to a mining partnership may be sued by a creditor of the partnership for the entire amount of liabilities arising from acts or omissions of the Operator. Similarly, a partnership for tax purposes will be created if the parties have a joint profit motive. Adverse tax consequences (beyond the scope of this paper) may be imposed, for example, if the parties agree to jointly market production for a period in excess of that provided for in Article VI.C. The Internal Revenue Service has ruled that although the association created under the terms of the form JOA may have sufficient characteristics to be taxed as a corporation, that status can be avoided if each party has the right to take production in kind. I.T. 3930, 1948-2 C.B. 126 Modified, I.T. 3933, 1948-2 C.B. 130; I.T. 3948, 1949-I C.B. 161.

The JOA does not explicitly define the fiduciary relationships among the parties. Amazingly few cases have addressed the duties and responsibilities of the Operator under a JOA. Frequently, it is the Operator who is primarily responsible for the acquisition of unleased acreage. When unleased acreage exists outside the Contract Area, the parties usually enter into an Area of Mutual Interest provision. Pursuant to an Area of Mutual Interest provision, the parties agree that the Operator shall make acquisitions or enter into farmins for the benefit of all the parties. Each party will normally have the right to elect to participate in the acquisition or farmin. (See Article XV.M. for an example.)

ARTICLE VI

continued

**** 1 "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the
 2 assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentage of participation in the
 3 Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of
 4 interests in the remaining portion of the Contract Area.
 5

6 Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from
 7 the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon re-
 8 quest, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges con-
 9 templated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned
 10 well. Upon proposed abandonment of the producing interval(s) assigned or leased, the assignor or lessor shall then have the option to
 11 repurchase its prior interest in the well (using the same valuation formula) and participate in further operations therein subject to the pro-
 12 visions hereof.
 13

14 3. Abandonment of Non-Consent Operations: The provisions of Article VI.E.1. or VI.E.2. above shall be applicable as between
 15 Consenting Parties in the event of the proposed abandonment of any well excepted from said Articles; provided, however, no well shall be
 16 permanently plugged and abandoned unless and until all parties having the right to conduct further operations therein have been notified
 17 of the proposed abandonment and afforded the opportunity to elect to take over the well in accordance with the provisions of this Article
 18 VI.E.
 19

ARTICLE VII.

EXPENDITURES AND LIABILITY OF PARTIES

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 21
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 23 A. Liability of Parties:

24
 25 The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and
 26 shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted
 27 among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor
 28 shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.
 29

30 B. Liens and Payment Defaults:

31
 32 Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share
 33 of oil and/or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon
 34 at the rate provided in Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the
 35 state, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the ob-
 36 taining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien
 37 rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share
 38 of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from
 39 the sale of such Non-Operator's share of oil and/or gas until the amount owed by such Non-Operator, plus interest, has been paid. Each
 40 purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien
 41 and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.
 42

43 If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by
 44 Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that
 45 the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain
 46 reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.
 47

48 C. Payments and Accounting:

49
 50 Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development
 51 and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective propor-
 52 tionate shares upon the expense basis provided in Exhibit "C". Operator shall keep an accurate record of the joint account hereunder,
 53 showing expenses incurred and charges and credits made and received.
 54

55 Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance
 56 of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding
 57 month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together
 58 with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted
 59 on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within
 60 fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount
 61 due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual ex-
 62 pense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.
 63

64 D. Limitation of Expenditures:

65
 66 1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened
 67 pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling or deepening shall include:
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Article VII

A. Liability of Parties - Continued

What happens if the parties execute a JOA and do not adopt an Area of Mutual Interest provision or a similar provision and an acquisition or farmin is made on acreage that is adjacent to the Contract Area? Under these circumstances, there is no obligation on any party making such acquisition or farmin to share the trade with the other parties. Article VIII.C., the provision of the JOA which addresses contributions, is limited in scope and only requires the Operator to share with the Non-Operators (or a Non-Operator with the other parties) acreage that is outside the Contract Area where the acreage outside the Contract Area is earned by the drilling of a well within the Contract Area. If the parties have ongoing relationships or expect to work together in the future, the acquisition or farmin may be offered to the other parties. One could view this as good business, although not a legal obligation. If, however, the parties focus on the acquisition of outside acreage and consciously decide not to enter into an Area of Mutual Interest provision, there is no obligation to share such acquired acreage.

As stated previously, there are very few cases that have addressed the fiduciary duties of an Operator in the context of its obligations under a JOA. Perhaps this is because the parties in the oil industry realize that due to the nature of the business, they will have to work together in the future and, consequently, they generally conduct their affairs in a fair, equitable manner. As business gets tougher, will industry alter its course of conduct? The "good old boy" syndrome has begun to erode. Consequently, it is more critical now to carefully structure expected behavior and whenever possible, this should be done in writing. If a dispute does arise, a good deal of attention will be devoted to whether this innocuous provision exculpates the Operator from the contention that it has abrogated its fiduciary duty.

While courts have recognized the principle that parties are free to contract as they see fit, courts have also imposed limitations which are found in undefined concepts of common law and notions of fairness and equity. Courts have had no problem applying a strict fiduciary standard where third parties have sought to impose joint liability on parties where the underlying agreement negated the joint venture/partnership relationship. 2 A. Williams & C. Meyers, 435 Oil and Gas Law 2. The Oklahoma Supreme Court in 1958 declined to impose a fiduciary standard on an Operator where the JOA contained language negating the creation of a mining partnership. Later in 1968, the court reversed itself and held that because the agreement was induced

ARTICLE VI

continued

***** 1 "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is located. The payments by, and the
2 assignments or leases to, the assignees shall be in a ratio based upon the relationship of their respective percentage of participation in the
3 Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of
4 interests in the remaining portion of the Contract Area.
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6 Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the operation of or production from
7 the well in the interval or intervals then open other than the royalties retained in any lease made under the terms of this Article. Upon re-
8 quest, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges con-
9 templated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned
10 well. Upon proposed abandonment of the producing interval(s) assigned or leased, the assignor or lessor shall then have the option to
11 repurchase its prior interest in the well (using the same valuation formula) and participate in further operations therein subject to the pro-
12 visions hereof.
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14 3. Abandonment of Non-Consent Operations: The provisions of Article VI.E.1. or VI.E.2. above shall be applicable as between
15 Consenting Parties in the event of the proposed abandonment of any well excepted from said Articles; provided, however, no well shall be
16 permanently plugged and abandoned unless and until all parties having the right to conduct further operations therein have been notified
17 of the proposed abandonment and afforded the opportunity to elect to take over the well in accordance with the provisions of this Article
18 VI.E.
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ARTICLE VII.

EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

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24
25 The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and
26 shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted
27 among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor
28 shall this agreement be construed as creating, a mining or other partnership or association, or to render the parties liable as partners.
29

B. Liens and Payment Defaults:

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32 Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share
33 of oil and/or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon
34 at the rate provided in Exhibit "C". To the extent that Operator has a security interest under the Uniform Commercial Code of the
35 state, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the ob-
36 taining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien
37 rights or security interest as security for the payment thereof. In addition, upon default by any Non-Operator in the payment of its share
38 of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from
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40 purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien
41 and security interest to the Non-Operators to secure payment of Operator's proportionate share of expense.
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43 If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of a statement therefor by
44 Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that
45 the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain
46 reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.
47

C. Payments and Accounting:

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50 Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development
51 and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective propor-
52 tionate shares upon the expense basis provided in Exhibit "C". Operator shall keep an accurate record of the joint account hereunder,
53 showing expenses incurred and charges and credits made and received.
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55 Operator, at its election, shall have the right from time to time to demand and receive from the other parties payment in advance
56 of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding
57 month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together
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62 pense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.
63

D. Limitation of Expenditures:

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66 1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened
67 pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling or deepening shall include:
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Article VII

A. Liability of Parties - Continued

by fraud, a fiduciary relationship existed, notwithstanding language that unambiguously negated such result. Oklahoma Co. v. O'Neil, 333 P.2d 534 (Okla. 1958), mandate recalled and decision vacated, 431 P.2d 445 (Okla. 1967), new opinion issued, 440 P.2d 978 (Okla. 1968). See also Prentice v. Amax Petroleum Corp., 220 So.2d 783 (La. Ct. App. 1969), cert. denied, 254 La. 455, 223 So.2d 867 (1969), where the court refused to impose a fiduciary relationship and compel a party whose top lease vested to share the lease with its JOA joint venturers.

The Wyoming Supreme Court has recently addressed the fiduciary relation within the scope of a JOA. The court in Madrid v. Norton, 596 P.2d 1108, 1119 (Wyo. 1979) held that "the burden of proving a joint venture is on the party asserting its existence. Moreover, the Madrid v. Norton court held that "Courts look with disfavor upon the claims of those who lie idle awaiting the results of development. The waiting may be years, months or days, depending on the circumstances. There is an inherent injustice in one purportedly holding a right to assert an ownership interest in property to voluntarily await the propitious event and then decide, when the danger which has been at the risk of another is over, to come in and claim a share of the profits." Id. at 1120. More recently in Andrau v. Michigan Wisconsin Pipeline, 712 P.2d 372 (Wyo. 1986), the Wyoming Supreme Court held that the JOA defined an Operator's fiduciary duty. Although the court held that the Operator owed a fiduciary duty to the Non-Operators, the court rejected the notion that a mining partnership exists where the parties have entered into a JOA. This "fiduciary duty" can, according to the Wyoming Supreme Court be limited by entering into a JOA. The court recognized that the JOA expressly negates an expansive fiduciary duty and that it explicitly defines the obligations and the relationships among the parties. Finally, the court ruled that parties could limit their fiduciary duties by executing a JOA and that courts are without power to rewrite the contract for the parties.

In appropriate situations, it may be advisable to further limit fiduciary responsibilities and to specify the conduct that is to be expected. In addition to the court in Andrau, courts in Oklahoma and New York have upheld specific waivers of fiduciary obligations. Frankfort Oil Co. v. Snakard, 279 F.2d 436 (10th Cir. 1960). See also Riveria Congress Associates v. Yassky, 25 A.D. 2d 291, 268 N.Y.S. 2d 854 (1966) aff'd, 18 N.Y. 2d 540, 223 N.E. 2d 876 (1966). Due to the difficulties of providing for every intended limitation on an Operator's fiduciary duty, parties wishing to negate fiduciary liability could expressly

ARTICLE VI

continued

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 9 templated by this agreement, plus any additional cost and charges which may arise as the result of the separate ownership of the assigned
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14 3. Abandonment of Non-Consent Operations: The provisions of Article VI.E.1. or VI.E.2. above shall be applicable as between
 15 Consenting Parties in the event of the proposed abandonment of any well excepted from said Articles; provided, however, no well shall be
 16 permanently plugged and abandoned unless and until all parties having the right to conduct further operations therein have been notified
 17 of the proposed abandonment and afforded the opportunity to elect to take over the well in accordance with the provisions of this Article
 18 VI.E.
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ARTICLE VII.

EXPENDITURES AND LIABILITY OF PARTIES

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 23 A. Liability of Parties:
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25 The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations, and
 26 shall be liable only for its proportionate share of the costs of developing and operating the Contract Area. Accordingly, the liens granted
 27 among the parties in Article VII.B. are given to secure only the debts of each severally. It is not the intention of the parties to create, nor
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30 B. Liens and Payment Defaults:
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32 Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share
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 38 of expense, Operator shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from
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 40 purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any default. Operator grants a like lien
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 45 the interest of each such party bears to the interest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain
 46 reimbursement thereof, be subrogated to the security rights described in the foregoing paragraph.
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48 C. Payments and Accounting:
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50 Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development
 51 and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective propor-
 52 tionate shares upon the expense basis provided in Exhibit "C". Operator shall keep an accurate record of the joint account hereunder,
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 56 of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding
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64 D. Limitation of Expenditures:
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66 1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened
 67 pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling or deepening shall include:
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Article VII

A. Liability of Parties - Continued

authorize permissible acts and provide for the waiver of all other duties. A provision which explicitly limits or waives an Operator's fiduciary duty and replaces it with a standard of good faith or fair dealing might well insulate an Operator from a judicial decision that imposes a strict fiduciary duty. Lane and Boggs, Duties of Operator or Manager To Its Joint Ventures, 29 Rocky Mtn. Min. L. Inst. 199 (1983).

B. Liens and Payment Defaults

Pursuant to this provision, each Non-Operator grants to Operator a lien on its oil and gas rights and a security interest on its share of production. Although Article VII.B. grants the creditor parties a lien and a security interest against any party to the JOA who has not paid its proportionate share of expenses, this provision may not provide the necessary security unless it is perfected by recording. In the event that the debtor becomes bankrupt, the creditor parties holding a lien and a security interest by virtue of the JOA may be classified as general creditors and, consequently, only be able to recover a small part of the debt.

To obtain priority under Article VII.B., Operators who have not filed the lien of record nor perfected their security interest, have argued that they should be given priority under the state statutory lien statute. In American National Bank of Austin v. Dux, 286 Ark. 309, 691 S.W.2d 851 (1985), the Operator persuaded the Supreme Court of Arkansas that even though American National Bank of Austin had recorded a mortgage almost three years prior to the oil well Operator's lien, under Ark. Stat. Ann. § 51-708 (1947) the miners lien had priority over the bank's mortgage. The court took notice of the fact that the bank obtained and recorded its mortgage after the leases were producing and, therefore, knew that the Operator was furnishing the necessary supplies and might later have to assert a lien for his advances.

There is some authority, under Texas law, that the statutory lien (Tex. Rev. Civ. Stat. Ann. art. 5473 (Vernon 1958) extends to the Operator, because the Operator is the person with whom the contract with the mechanic or material man is made. In Mood v. Methodist Episcopal Church South of Cisco, 296 S.W. 506 (Tex. Comm'n App. 1927), modified on reh'g, 300 S.W. 30 (Tex. Comm'n App. 1927) the court held that the term "labor" as used in Article 5473 included the supervision of a construction project and that both the materials and labor supplied by the entity supervising the construction operation were secured by

ARTICLE VI

continued

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 8 quest, Operator shall continue to operate the assigned well for the account of the non-abandoning parties at the rates and charges con-
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 16 permanently plugged and abandoned unless and until all parties having the right to conduct further operations therein have been notified
 17 of the proposed abandonment and afforded the opportunity to elect to take over the well in accordance with the provisions of this Article
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ARTICLE VII.

EXPENDITURES AND LIABILITY OF PARTIES

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Article VII

B. Liens and Payment Defaults - Continued

virtue of the Article 5473 statutory lien. See Lodal & Bain Engineers, Inc. v. Bayfield Public Utility District, 583 S.W.2d 653 (Tex. Civ. App.-Houston [1st Dist.] 1979, writ granted); Sanguinett & Statts v. Colorado Salt Co., 150 S.W. 490 (Tex. Civ. App.-Fort Worth 1912, writ ref'd) which held that engineers and architects who contribute services in construction projects are protected by the general mechanics' and materialsmen's liens. See also Heaney, The Joint Operating Agreement, the AFE and COPAS - What They Fail to Provide, 29 Rocky Mtn. Min. L. Inst. 743, 766 (1983) where Mr. Heaney states "Absent some overriding public policy, the Operator should have the benefit of the Statutory Lien." But see Gray v. Magdalena Oil Co., 240 S.W. 693 (Tex. Civ. App. - El Paso 1922, no writ) (which held that neither hauling materials to the wellsite nor furnishing materials was within the purview of the statutory lien); Bell Oil & Refining Co. v. Price, 251 S.W. 559 (Tex. Civ. App.-Fort Worth 1923, no writ) (which held that the mere watching of a lease was not within the scope of the statutory lien, which requires the exertion of muscular force). An argument could thus be made that the statutory lien protects and secures the Operator when it is acting as an independent contractor for the benefit of the Non-Operators. See Heaney, The Joint Operating Agreement, The AFE and COPAS - What They Fail to Provide, 29 Rocky Mtn. Min. L. Inst. 743, 765-66 (1983). The statutory lien provisions of Wyoming, Montana, New Mexico and Colorado are similar to what exists in Texas. The Louisiana statutory lien (La. Rev. Stat. Ann. § 9:4861 (West 1950)) secures amounts owed by Non-Operators to Operator. Kenmore Oil Company v. Delacroix, 316 So.2d 468 (La. Ct. App. 1975). The Mississippi statutory lien (Miss. Code Ann. § 85-7-131 (1972)) expressly grants the Operator a statutory lien. The statutory lien will probably not protect an Operator in Oklahoma, Kansas, or Illinois. See Uncle Sam Oil Co. v. Richards, 60 Okla. 63, 158 P. 1187 (1916); Gaudreau v. Smith, 137 Kan. 644, 21 P.2d 330 (1933). But see Davis v. Sherman, 149 Kan. 104, 86 P.2d 490 (1939); Kinne v. Duncan, 315 Ill. App. 577, 43 N.E. 2d 425 (1942).

Rather than rely on a judicial interpretation that the state's statutory lien provides creditor parties with priority and security, the parties might consider filing the Operating Agreement of record or filing a Memorandum of Operating Agreement, perfecting a security interest under the Uniform Commercial Code or filing a lien statement. The perfection of a security interest is advantageous because a conveyance of real property or an interest therein is: (1) void as to a creditor or subsequent purchaser for value without notice unless the instrument has been filed for record, (2) subordinate to a

ARTICLE VI

continued

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 60 fifteen (15) days after such estimate and invoice is received. If any party fails to pay its share of said estimate within said time, the amount
 61 due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual ex-
 62 pense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.
 63

64 D. Limitation of Expenditures:

65
 66 1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, except any well drilled or deepened
 67 pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling or deepening shall include:
 68
 69
 70

Article VII

B. Liens and Payment Defaults - Continued

person who becomes a lien creditor before the security interest is perfected, and (3) a trustee in bankruptcy, without regard to knowledge, may avoid unperfected liens under the bankruptcy code. The discussion associated with Article XV.P. provides a further analysis of the benefits of filing of record a Memorandum of Operating Agreement and Financing Statement and offers a form of Memorandum of Operating Agreement and Financing Statement.

Operator may take comfort in its right in the event of a default to collect directly from the purchaser of the defaulting party's share of production until the amount owed, plus interest, is paid in full. This right may give an Operator a false sense of security, however, because rather than remit proceeds to the Operator, purchasers frequently suspend payment for that part of any oil and gas purchase which is attributable to the defaulting party's interest.

C. Payments and Accounting

The Operator, at its election, may "cash call" or require that a Non-Operator prepay expenses. This provision is limited in that the Operator can only demand from the Non-Operators advance payment of the estimated expenses to be incurred during the next succeeding month. In appropriate situations, the Operator might wish to insert a "cash call" provision which would cover the balance of the cost of the operation. Such language can be incorporated in Article XV and is addressed in Article XV.A. and Article XV.B. herein.

ARTICLE VII

continued

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

3
**** 4 Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its
5 authorized depth, and all tests have been completed, and the results thereof furnished to the parties, Operator shall give immediate notice
6 to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight
7 (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion at-
8 tempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, in-
9 cluding necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall
10 constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties,
11 elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging
12 back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less
13 than all parties.
14

15 2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or
16 plugged back pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the reworking or plugging back of a well shall
17 include all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage
18 and/or surface facilities.
19

20 3. Other Operations: Without the consent of all parties, Operator shall not undertake any single project reasonably estimated
**** 21 to require an expenditure in excess of Twenty-Five Thousand- - - - - Dollars (\$ 25,000.00- - - - -)
22 except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been
23 previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden
24 emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required
25 to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other
26 parties. If Operator prepares an authority for expenditure (AFE) for its own use, Operator shall furnish any Non-Operator so requesting
**** 27 an information copy thereof for any single project costing in excess of Twenty-Five Thousand- - - - -
28 Dollars (\$ 25,000.00- - - - -) but less than the amount first set forth above in this paragraph.
29

30 E. Rentals, Shut-in Well Payments and Minimum Royalties:

31
32 Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the
33 party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have con-
34 tributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on
35 behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of
36 failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such pay-
37 ment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the pro-
38 visions of Article IV.B.2.
39

40 Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production
41 of a producing gas well, at least five (5) days (excluding Saturday, Sunday and legal holidays), or at the earliest opportunity permitted by
42 circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify
43 Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments of any shut-in well payment
44 shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

**** 45 When sales commence, Operator shall notify Non-Operator of the date of first sale.

46 F. Taxes:

47
48 Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property
49 subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they
50 become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not
51 be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-
52 Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, over-
53 riding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or
54 owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduc-
55 tion. If the ad valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then notwithstanding
56 anything to the contrary herein, charges to the joint account shall be made and paid by the parties hereto in accordance with the tax
57 value generated by each party's working interest. Operator shall bill the other parties for their proportionate shares of all tax payments in
58 the manner provided in Exhibit "C".
59

60 If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner
61 prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final deter-
62 mination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any
63 interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint ac-
64 count, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as
65 provided in Exhibit "C".
66

67 Each party shall pay or cause to be paid all production, severance, excise, gathering and other taxes imposed upon or with respect to
68 the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.
69
70

Pages 9 and 10 - JOA

Article VII
(Individual Loss)

D. Limitation Expenditures

It is recommended that in most situations Option No. 2 be selected. Option No. 1 provides that all costs through completion be included in a party's consent to an operation. Option No. 2 contains what is known as a "casing point election" wherein parties are given an election either to participate or not to participate in the completion attempt.

The monetary amounts to be inserted in lines 21, 27 and 28 are negotiable. Generally, this is not a point of contention. If you are the Operator or the Operator is a trustworthy company, it is recommended that \$25,000 be included in both blanks. If as a Non-Operator you want greater protection, insert a smaller number.

AFE's are disseminated to satisfy Article VI.B.1., which mandates that notice be given of any proposed operation, specifying the work to be performed, the location, proposed depth, objective formations and the estimated cost of the operation. AFE's are generally considered estimates of the costs anticipated and not firm commitments. In the case of Sonat Exploration Company v. Mann, 785 F.2d 1232 (5th Cir. 1986), the Fifth Circuit, interpreting Mississippi law, held that AFE's executed by a Non-Operator who is not a party to a JOA do not obligate the Non-Operator to pay for the cost of drilling, completing or sidetracking a well. In M&T, Inc. v. Fuel Resources Development Co., 518 F.Supp. 285 (D. Colo. 1981), a Non-Operator declared his intention to go non-consent on a well that had exceeded the AFE, but had not reached objective depth. The court held that the JOA did not permit a party to go non-consent during the drilling phase and that the AFE was only an estimate of the costs and not a limitation on the Operator's authority.

Before consenting to an operation, parties should carefully scrutinize the AFE. To challenge an operation that exceeded the AFE, a party could argue that the excessive costs were not "necessary or proper" as required by Article II.12. of the 1974 COPAS or Article II.15. of the 1984 COPAS or that the costs were "not reasonable and necessary" as analogized to the common law rules relating to a drilling co-tenant's right to reimbursement. Although it is customary for the Operator to submit a revised informational AFE if costs exceed 10% of the original AFE, unless able to prove gross negligence or willful neglect, a Non-Operator is not likely to prevail in a suit to challenge the reasonableness of costs in excess of an AFE. To protect itself, a Non-Operator could, on the face of the AFE, provide that if the costs exceed a specific amount (125% of AFE costs) the

ARTICLE VII

continued

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

3
**** 4 Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its
5 authorized depth, and all tests have been completed, and the results thereof furnished to the parties, Operator shall give immediate notice
6 to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight
7 (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion at-
8 tempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, in-
9 cluding necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall
10 constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties,
11 elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging
12 back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less
13 than all parties.

14
15 2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or
16 plugged back pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the reworking or plugging back of a well shall
17 include all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage
18 and/or surface facilities.

19
**** 20 3. Other Operations: Without the consent of all parties, Operator shall not undertake any single project reasonably estimated
21 to require an expenditure in excess of Twenty-Five Thousand- - - - - Dollars (\$ 25,000.00- - - - -)
22 except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been
23 previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden
24 emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required
25 to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other
26 parties. If Operator prepares an authority for expenditure (AFE) for its own use, Operator shall furnish any Non-Operator so requesting
**** 27 an information copy thereof for any single project costing in excess of Twenty-Five Thousand- - - - -
28 Dollars (\$ 25,000.00- - - - -) but less than the amount first set forth above in this paragraph.

29
30 E. Rentals, Shut-in Well Payments and Minimum Royalties:

31
32 Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the
33 party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have con-
34 tributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on
35 behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of
36 failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such pay-
37 ment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the pro-
38 visions of Article IV.B.2.

39
40 Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production
41 of a producing gas well, at least five (5) days (excluding Saturday, Sunday and legal holidays), or at the earliest opportunity permitted by
42 circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify
43 Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments of any shut-in well payment
44 shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

**** 45 When sales commence, Operator shall notify Non-Operator of the date of first sale.

46 F. Taxes:

47
48 Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property
49 subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they
50 become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not
51 be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-
52 Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, over-
53 riding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or
54 owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduc-
55 tion. If the ad valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then notwithstanding
56 anything to the contrary herein, charges to the joint account shall be made and paid by the parties hereto in accordance with the tax
57 value generated by each party's working interest. Operator shall bill the other parties for their proportionate shares of all tax payments in
58 the manner provided in Exhibit "C".

59
60 If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner
61 prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final deter-
62 mination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any
63 interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint ac-
64 count, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as
65 provided in Exhibit "C".

66
67 Each party shall pay or cause to be paid all production, severance, excise, gathering and other taxes imposed upon or with respect to
68 the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.

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Article VII
(Individual Loss)

D. Limitation of Expenditures - Continued

Operator would bear all excess costs. Alternatively, the Non-Operator could go non-consent as to all excess costs and the Operator would be able to recoup the extra cost with interest or a premium before the non-consenting parties come back in at their original participation level. Heaney, The Joint Operation Agreement, the AFE and COPAS - What They Fail to Provide, 29 Rocky Mtn. Min. L. Inst. 743 (1983). If the Operator accepted the conditional terms offered by the Non-Operator in an AFE, the JOA would be amended only as between the Operator and the Non-Operator. The Operator's legal obligations and relation with other Non-Operators is unaffected by this side agreement. The Operator, by accepting such a conditional approval of an AFE, is agreeing that it individually will carry a Non-Operator if the cost exceeds the AFE. The Operator cannot by itself bind the other Non-Operator's and, consequently, the other Non-Operators (if any) are unaffected by this side agreement. Unless this process is carefully orchestrated, an Operator may claim that a Non-Operator, by conditioning its acceptance, elected not to participate in the proposed operation.

E. Rentals, Shut-in Well Payments and Minimum Royalties

Rentals, shut-in payments and minimum royalties are to be paid by the party or parties contributing the lease. To permit a party to make a shut-in payment, the Operator is required to notify Non-Operators of the anticipated completion of a shut-in gas well, or the shutting-in or return to production of a producing gas well. This provision does not require the Operator to notify Non-Operators of the date of first sale. To enable a Non-Operator to curtail shut-in payments when a well that has never produced begins producing, it is recommended that the following concluding sentence be inserted: "When sales commence, Operator shall notify Non-Operator of the date of first sale."

F. Taxes

While the Operator will pay all ad valorem taxes, each party is to pay its production, severance, excise gathering and other taxes.

ARTICLE VII

continued

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

3
**** 4 Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its
5 authorized depth, and all tests have been completed, and the results thereof furnished to the parties, Operator shall give immediate notice
6 to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight
7 (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion at-
8 tempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, in-
9 cluding necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall
10 constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties,
11 elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging
12 back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less
13 than all parties.
14

15 2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or
16 plugged back pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the reworking or plugging back of a well shall
17 include all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage
18 and/or surface facilities.
19

20 3. Other Operations: Without the consent of all parties, Operator shall not undertake any single project reasonably estimated
**** 21 to require an expenditure in excess of Twenty-Five Thousand- - - - - - Dollars (\$ 25,000.00- - - - - -)
22 except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been
23 previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden
24 emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required
25 to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other
26 parties. If Operator prepares an authority for expenditure (AFE) for its own use, Operator shall furnish any Non-Operator so requesting
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30 E. Rentals, Shut-in Well Payments and Minimum Royalties:

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32 Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the
33 party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have con-
34 tributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on
35 behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of
36 failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such pay-
37 ment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the pro-
**** 38 visions of Article IV.B.3.
39

40 Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production
41 of a producing gas well, at least five (5) days (excluding Saturday, Sunday and legal holidays), or at the earliest opportunity permitted by
42 circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify
43 Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments of any shut-in well payment
44 shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.
**** 45 When sales commence, Operator shall notify Non-Operator of the date of first sale.

46 F. Taxes:

47
48 Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property
49 subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they
50 become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not
51 be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-
52 Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, over-
53 riding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or
54 owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduc-
55 tion. If the ad valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then notwithstanding
56 anything to the contrary herein, charges to the joint account shall be made and paid by the parties hereto in accordance with the tax
57 value generated by each party's working interest. Operator shall bill the other parties for their proportionate shares of all tax payments in
58 the manner provided in Exhibit "C".
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60 If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner
61 prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final deter-
62 mination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any
63 interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint ac-
64 count, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as
65 provided in Exhibit "C".
66

67 Each party shall pay or cause to be paid all production, severance, excise, gathering and other taxes imposed upon or with respect to
68 the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.
69
70

Pages 9 and 10 - JOA

Article VII
(Joint Loss)

D. Limitation of Expenditures

It is recommended that in most situations Option No. 2 be selected. Option No. 1 provides that all costs through completion be included in a party's consent to an operation. Option No. 2 contains what is known as a "casing point election" wherein parties are given an election either to participate or not to participate in the completion attempt.

The monetary amounts to be inserted in lines 21, 27 and 28 are negotiable. Generally, this is not a point of contention. If you are the Operator or the Operator is a trustworthy company, it is recommended that \$25,000 be included in both blanks. If as a Non-Operator you want greater protection, insert a smaller number.

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ARTICLE VII

continued

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

3
**** 4 Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When such well has reached its
5 authorized depth, and all tests have been completed, and the results thereof furnished to the parties, Operator shall give immediate notice
6 to the Non-Operators who have the right to participate in the completion costs. The parties receiving such notice shall have forty-eight
7 (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion at-
8 tempt. Such election, when made, shall include consent to all necessary expenditures for the completing and equipping of such well, in-
9 cluding necessary tankage and/or surface facilities. Failure of any party receiving such notice to reply within the period above fixed shall
10 constitute an election by that party not to participate in the cost of the completion attempt. If one or more, but less than all of the parties,
11 elect to set pipe and to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or plugging
12 back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to the operations thereafter conducted by less
13 than all parties.
14

15 2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged back except a well reworked or
16 plugged back pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the reworking or plugging back of a well shall
17 include all necessary expenditures in conducting such operations and completing and equipping of said well, including necessary tankage
18 and/or surface facilities.
19

20 3. Other Operations: Without the consent of all parties, Operator shall not undertake any single project reasonably estimated
**** 21 to require an expenditure in excess of Twenty-Five Thousand- - - - - Dollars (\$ 25,000.00- - - - -)
22 except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plugging back of which has been
23 previously authorized by or pursuant to this agreement; provided, however, that, in case of explosion, fire, flood or other sudden
24 emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required
25 to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other
26 parties. If Operator prepares an authority for expenditure (AFE) for its own use, Operator shall furnish any Non-Operator so requesting
**** 27 an information copy thereof for any single project costing in excess of Twenty-Five Thousand- - - - -
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29

30 E. Rentals, Shut-in Well Payments and Minimum Royalties:

31
32 Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the
33 party or parties who subjected such lease to this agreement at its or their expense. In the event two or more parties own and have con-
34 tributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on
35 behalf of all such parties. Any party may request, and shall be entitled to receive, proper evidence of all such payments. In the event of
36 failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such pay-
37 ment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the pro-
**** 38 visions of Article IV.B.2.3.
39

40 Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shutting in or return to production
41 of a producing gas well, at least five (5) days (excluding Saturday, Sunday and legal holidays), or at the earliest opportunity permitted by
42 circumstances, prior to taking such action, but assumes no liability for failure to do so. In the event of failure by Operator to so notify
43 Non-Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments of any shut-in well payment
44 shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

**** 45 When sales commence, Operator shall notify Non-Operator of the date of first sale.

46 F. Taxes:

47
48 Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property
49 subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they
50 become delinquent. Prior to the rendition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not
51 be limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests contributed by such Non-
52 Operator. If the assessed valuation of any leasehold estate is reduced by reason of its being subject to outstanding excess royalties, over-
53 riding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or
54 owners of such leasehold estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduc-
55 tion. If the ad valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then notwithstanding
56 anything to the contrary herein, charges to the joint account shall be made and paid by the parties hereto in accordance with the tax
57 value generated by each party's working interest. Operator shall bill the other parties for their proportionate shares of all tax payments in
58 the manner provided in Exhibit "C".
59

60 If Operator considers any tax assessment improper, Operator may, at its discretion, protest within the time and manner
61 prescribed by law, and prosecute the protest to a final determination, unless all parties agree to abandon the protest prior to final deter-
62 mination. During the pendency of administrative or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any
63 interest and penalty. When any such protested assessment shall have been finally determined, Operator shall pay the tax for the joint ac-
64 count, together with any interest and penalty accrued, and the total cost shall then be assessed against the parties, and be paid by them, as
65 provided in Exhibit "C".
66

67 Each party shall pay or cause to be paid all production, severance, excise, gathering and other taxes imposed upon or with respect to
68 the production or handling of such party's share of oil and/or gas produced under the terms of this agreement.
69
70

Article VII
(Joint Loss)

D. Limitation of Expenditures - Continued

Operator would bear all excess costs or that the Non-Operator could go non-consent as to all excess costs and the Operator would be able to recoup the extra cost with interest or a premium before the non-consenting parties back in for their original participation. Heaney, The Joint Operation Agreement, the AFE and COPAS - What They Fail to Provide, 29 Rocky Mtn. Min. L. Inst. 743 (1983). If the Operator accepted the conditional terms offered by the Non-Operator in an AFE, the JOA would be amended only as between the Operator and the Non-Operator. The Operator's legal obligations and relation with other Non-Operators is unaffected by this side agreement. The Operator by accepting such a conditional approval of an AFE, is agreeing that it individually will carry a Non-Operator if the cost exceeds the AFE. The Operator cannot by itself bind the other Non-Operator's and, consequently, the other Non-Operators (if any) are unaffected by this side agreement. Unless this process is carefully orchestrated, an Operator may claim that a Non-Operator, by conditioning its acceptance, elected not to participate in the proposed operation.

E. Rentals, Shut-in Well Payments and Minimum Royalties

Rentals, shut-in payments and minimum royalties are to be paid by the party or parties contributing the lease. To permit a party to make a shut-in payment, the Operator is required to notify Non-Operators of the anticipated completion of a shut-in gas well, or the shutting-in or return to production of a producing gas well. This provision does not require the Operator to notify Non-Operators of the date of first sale. To enable a Non-Operator to curtail shut-in payments when a well that has never produced begins producing, it is recommended that the following concluding sentence be inserted: "When sales commence, Operator shall notify Non-Operator of the date of first sale."

As part of the procedure to modify the form to provide for joint loss, line 38 needs to be amended to reference Article IV.B.3., since Article IV.3.2. has been deleted.

F. Taxes

While the Operator will pay all ad valorem taxes, each party is to pay its production, severance, excise gathering and other taxes.

ARTICLE VII

continued

1 G. Insurance:

2
 3 At all times while operations are conducted hereunder, Operator shall comply with the workmen's compensation law of
 4 the state where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said com-
 5 pensation laws in which event the only charge that shall be made to the joint account shall be as provided in Exhibit "C". Operator shall
 ***** 6 also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part
 7 hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the workmen's compensation
 8 law of the state where the operations are being conducted and to maintain such other insurance as Operator may require.
 9

***** 10 In the event automobile public liability insurance is specified in said Exhibit "D", or subsequently receives the approval of the
 11 parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's automotive equipment.
 12
 13

ARTICLE VIII.

ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

14
 15
 16 A. Surrender of Leases:

17
 18 The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole
 19 or in part unless all parties consent thereto.
 20

21 However, should any party desire to surrender its interest in any lease or in any portion thereof, and the other parties do not
 22 agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in
 23 such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production
 ***** 24 thereafter secured, to the parties not consenting to such surrender. If the interest of the assigning party is or includes an oil and gas in-
 25 terest, the assigning party shall execute and deliver to the party or parties not consenting to such surrender an oil and gas lease covering
 26 such oil and gas interest for a term of one (1) year and so long thereafter as oil and/or gas is produced from the land covered thereby, such
 27 lease to be on the form attached hereto as Exhibit "B". Upon such assignment or lease, the assigning party shall be relieved from all
 28 obligations thereafter accruing, but not theretofore accrued, with respect to the interest assigned or leased and the operation of any well
 29 attributable thereto, and the assigning party shall have no further interest in the assigned or leased premises and its equipment and pro-
 30 duction other than the royalties retained in any lease made under the terms of this Article. The party assignee or lessee shall pay to the
 31 party assignor or lessor the reasonable salvage value of the latter's interest in any wells and equipment attributable to the assigned or leas-
 32 ed acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of
 33 salvaging and the estimated cost of plugging and abandoning. If the assignment or lease is in favor of more than one party, the interest
 34 shall be shared by such parties in the proportions that the interest of each bears to the total interest of all such parties.
 35

36 Any assignment, lease or surrender made under this provision shall not reduce or change the assignor's, lessor's or surrendering
 37 party's interest as it was immediately before the assignment, lease or surrender in the balance of the Contract Area; and the acreage
 38 assigned, leased or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this
 39 agreement.
 40

41 B. Renewal or Extension of Leases:

42
 43 If any party secures a renewal of any oil and gas lease subject to this agreement, all other parties shall be notified promptly, and
 44 shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the
 45 renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper pro-
 46 portionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the
 47 interests held at that time by the parties in the Contract Area.
 48

49 If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties
 50 who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area
 51 to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease.
 52 Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.
 53

54 Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein
 55 by the acquiring party.
 56

57 The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease
 58 or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or
 59 contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or con-
 60 tracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to
 61 the provisions of this agreement.
 62

63 The provisions in this Article shall also be applicable to extensions of oil and gas leases.
 64

65 C. Acreage or Cash Contributions:

66
 67 While this agreement is in force, if any party contracts for a contribution of cash towards the drilling of a well or any other
 68 operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be
 69 applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the con-
 70 tribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions

Article VII

G. Insurance

This provision requires that the Operator comply with the workers' compensation law of the state and carry additional insurance as agreed to by the parties. Article VII.G. assumes that an Insurance Provision will be attached and designated as Exhibit "D". If an insurance provision is not attached, the references on lines 6, 7, 10 and 11 should be deleted.

Article VIII

A. Surrender of Leases

Under this provision, before a lease or an oil and gas interest can be surrendered, it must be offered to the other parties. Note that the surrender of a lease or an oil and gas interest does not reduce the surrendering parties' interest in the Contract Area. While it is logical that a party surrendering its interest in a lease should not maintain an interest in the lease by virtue of the JOA, it does not necessarily follow that the surrendering parties' interest should not be reduced in the Contract Area. To understand this distinction, it must be remembered that the parties to a JOA have "pooled" their leasehold interests and have contractually agreed to develop the acreage in specific proportions. The contract interest does not have to relate to the leasehold acreage committed by the parties. The fact that a surrendering party's leasehold interest in the Contract Area has decreased should not concomitantly trigger a reduction in the surrendering party's contract interest. If one or more of the non-surrendering parties wished to acquire the surrendered acreage, they can do so and such acreage would not be governed by the JOA.

If the parties to the Agreement do not own unleased oil and gas interests, delete the reference thereto on lines 24 to 27 on page 11.

Surrendered interests are not governed by the JOA. The parties to the JOA may want to provide that, in the event more than one party acquires such acreage, all future operations shall be governed by an identical JOA. (See Article XV.K. for an example of such a provision.)

B. Renewal or Extension of Leases

Any lease which is renewed or extended within six months after expiration shall be shared by all parties (not just the party or parties who contributed the lease) in proportion to their

ARTICLE VII

continued

1 G. Insurance:

2
3 At all times while operations are conducted hereunder, Operator shall comply with the workmen's compensation law of
4 the state where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said com-
5 pensation laws in which event the only charge that shall be made to the joint account shall be as provided in Exhibit "C". Operator shall
***** 6 also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part
7 hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the workmen's compensation
8 law of the state where the operations are being conducted and to maintain such other insurance as Operator may require.
9

***** 10 In the event automobile public liability insurance is specified in said Exhibit "D", or subsequently receives the approval of the
11 parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's automotive equipment.
12
13

ARTICLE VIII.

ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

14
15
16 A. Surrender of Leases:

17
18 The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall not be surrendered in whole
19 or in part unless all parties consent thereto.
20

21 However, should any party desire to surrender its interest in any lease or in any portion thereof, and the other parties do not
22 agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in
23 such lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production
***** 24 thereafter secured, to the parties not consenting to such surrender. If the interest of the assigning party is or includes an oil and gas in-
25 terest, the assigning party shall execute and deliver to the party or parties not consenting to such surrender an oil and gas lease covering
26 such oil and gas interest for a term of one (1) year and so long thereafter as oil and/or gas is produced from the land covered thereby, such
27 lease to be on the form attached hereto as Exhibit "B". Upon such assignment or lease, the assigning party shall be relieved from all
28 obligations thereafter accruing, but not theretofore accrued, with respect to the interest assigned or leased and the operation of any well
29 attributable thereto, and the assigning party shall have no further interest in the assigned or leased premises and its equipment and pro-
30 duction other than the royalties retained in any lease made under the terms of this Article. The party assignee or lessee shall pay to the
31 party assignor or lessor the reasonable salvage value of the latter's interest in any wells and equipment attributable to the assigned or leas-
32 ed acreage. The value of all material shall be determined in accordance with the provisions of Exhibit "C", less the estimated cost of
33 salvaging and the estimated cost of plugging and abandoning. If the assignment or lease is in favor of more than one party, the interest
34 shall be shared by such parties in the proportions that the interest of each bears to the total interest of all such parties.
35

36 Any assignment, lease or surrender made under this provision shall not reduce or change the assignor's, lessor's or surrendering
37 party's interest as it was immediately before the assignment, lease or surrender in the balance of the Contract Area; and the acreage
38 assigned, leased or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this
39 agreement.
40

41 B. Renewal or Extension of Leases:

42
43 If any party secures a renewal of any oil and gas lease subject to this agreement, all other parties shall be notified promptly, and
44 shall have the right for a period of thirty (30) days following receipt of such notice in which to elect to participate in the ownership of the
45 renewal lease, insofar as such lease affects lands within the Contract Area, by paying to the party who acquired it their several proper pro-
46 portionate shares of the acquisition cost allocated to that part of such lease within the Contract Area, which shall be in proportion to the
47 interests held at that time by the parties in the Contract Area.
48

49 If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it shall be owned by the parties
50 who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area
51 to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal lease.
52 Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.
53

54 Each party who participates in the purchase of a renewal lease shall be given an assignment of its proportionate interest therein
55 by the acquiring party.
56

57 The provisions of this Article shall apply to renewal leases whether they are for the entire interest covered by the expiring lease
58 or cover only a portion of its area or an interest therein. Any renewal lease taken before the expiration of its predecessor lease, or taken or
59 contracted for within six (6) months after the expiration of the existing lease shall be subject to this provision; but any lease taken or con-
60 tracted for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal lease and shall not be subject to
61 the provisions of this agreement.
62

63 The provisions in this Article shall also be applicable to extensions of oil and gas leases.
64

65 C. Acreage or Cash Contributions:

66
67 While this agreement is in force, if any party contracts for a contribution of cash towards the drilling of a well or any other
68 operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be
69 applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party to whom the con-
70 tribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions

Article VIII

B. Renewal or Extension of Leases - Continued

interest in the Contract Area at the time the JOA was signed. Renewal is defined as a lease that is taken within six months after the expiration of the existing lease. If some, but not all, the parties elect to participate in a renewal or extension, it shall be owed by the participating parties in the proportion their ownership in the Contract Area bears to the aggregate of their ownership in the Contract Area. In this event, the lease renewal or extension shall not be governed by a JOA. To eliminate what might prove to be difficult and time-consuming negotiations, the parties may wish to provide that any future operations on such acreage shall be governed by an identical JOA. (See Article XV.K. for an example of such a provision.)

C. Acreage or Cash Contribution

In accordance with this provision, the Drilling Parties share all acreage and cash contributions. In addition, the Drilling Parties share all optional rights to earn acreage outside the Contract Area which are in support of a well drilled inside the Contract Area. This provision does not explicitly reference farmout acreage located within the Contract Area, because the parties to a JOA develop the Contract Area in the proportions set out on Exhibit "A" and; consequently, all option farmouts and farmout acreage earned within the Contract Area are shared by the parties in proportion to their interest in the Contract Area.

ARTICLE VIII

continued

1 said Drilling Parties shared the cost of drilling the well. Such acreage shall become a separate Contract Area and, to the extent possible, be
2 governed by provisions identical to this agreement. Each party shall promptly notify all other parties of any acreage or cash contributions
3 it may obtain in support of any well or any other operation on the Contract Area. The above provisions shall also be applicable to op-
***** 4 tional rights to earn acreage outside the Contract Area which are in support of a well drilled inside the Contract Area.

5
6 If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such
7 consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

8
9 D. Maintenance of Uniform Interest:

10
11 For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, no
12 party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells,
13 equipment and production unless such disposition covers either:

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

16
17
18 Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement
19 and shall be made without prejudice to the right of the other parties.

20
21 If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may
22 require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for
23 and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such
24 party's interest within the scope of the operations embraced in this agreement; however, all such co-owners have the right to enter
25 into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract
26 Area and they shall have the right to receive, separately, payment of the sale proceeds thereof.

27
28
29 E. Waiver of Rights to Partition:

30
31 If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an
32 undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided
33 interest therein.

34
35 F. Preferential Right to Purchase:

36
37 Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract
38 Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the
39 name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms
40 of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase
41 on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchas-
42 ing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing par-
43 ties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to
44 dispose of its interests by merger, reorganization, consolidation, ~~or sale of all or substantially all of its assets to a subsidiary or parent com-
***** 45 pany or to a subsidiary of a parent company,~~ or to any company in which any one party owns a majority of the stock.
46 ~~*or the sale of substantially all of its assets, or a sale or transfer of its
interests to a subsidiary or a parent company, or subsidiary of a parent company,~~

47 ARTICLE IX.

48 INTERNAL REVENUE CODE ELECTION

49
***** 50 This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association
51 for profit between or among the parties hereto. Notwithstanding any provision herein that the rights and liabilities hereunder are several
52 and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for federal income tax
53 purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded
54 from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as per-
55 mitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to ex-
56 ecute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the
57 United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements,
58 and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further
59 evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the
60 Federal Internal Revenue Service or as may be necessary to evidence this election. No such party shall give any notices or take any other
61 action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract
62 Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1,
63 Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is per-
64 mitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing elec-
65 tion, each such party states that the income derived by such party from operations hereunder can be adequately determined without the
66 computation of partnership taxable income.

Article VIII

D. Maintenance and Uniform Interest

For administrative convenience this provision prohibits the transfer of a divided interest, and gives the Operator the discretion to require parties that own an interest that has been divided among four or more co-owners to appoint an agent to whom the Operator can look. Generally, this provision should not be deleted. Remember, while you may be a Non-Operator today, you may be the Operator tomorrow. Article VIII.D. is frequently violated, perhaps because there is no associated penalty for transferring some but not all of the leases committed to a JOA.

F. Preferential Right to Purchase

Frequently, this language is deleted. If it is possible that you may wish to acquire all or any part of a party's interest in the JOA, and by so doing increase your interest in the JOA, you should seek to ensure that this language is not deleted. In addition, Article VIII.F. provides the parties to a JOA some assurance that they will not have to deal with entities with whom they do not want to do business. If a party wishes to sell its interest and another party is concerned about the entity that might purchase the interest, the other party can use this provision to acquire the selling party's interest. Article VIII.F. is frequently deleted because it is believed by many landmen to restrict the marketability of its interest. The terms of this provision require that a party desiring to sell its interest notify and give a right of first refusal to the other parties. It is believed, by some, that prospective purchasers will be reticent about offering to purchase an interest when other parties have a preferential right to purchase or a right of first refusal on the same terms offered by the prospective purchaser.

Although it has not yet precipitated significant litigation, the last sentence of this provision is fraught with potential problems. Companies today frequently sell large blocks of acreage which include acreage committed to a JOA with a preferential right to purchase provision or sell the entire company. Pursuant to a literal interpretation of Article VIII.F., acreage committed to a JOA, which is being sold subject to a sale which includes other acreage, should be separately valued and offered to the other parties. This is in fact rarely done. Either the selling company disseminates notices advising that it is making such a sale and no preferential right to purchase exists or the selling company simply ignores Article VIII.F.

ARTICLE VIII

continued

1 said Drilling Parties shared the cost of drilling the well. Such acreage shall become a separate Contract Area and, to the extent possible, be
2 governed by provisions identical to this agreement. Each party shall promptly notify all other parties of any acreage or cash contributions
3 it may obtain in support of any well or any other operation on the Contract Area. The above provisions shall also be applicable to op-
**** 4 tional rights to earn acreage outside the Contract Area which are in support of a well drilled inside the Contract Area.

5
6 If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such
7 consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

8
9 D. Maintenance of Uniform Interest:

10
11 For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, no
12 party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells,
13 equipment and production unless such disposition covers either:

- 14
15 1. the entire interest of the party in all leases and equipment and production; or
16
17 2. an equal undivided interest in all leases and equipment and production in the Contract Area.

18
19 Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement
20 and shall be made without prejudice to the right of the other parties.

21
22 If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may
23 require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for
24 and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such
25 party's interest within the scope of the operations embraced in this agreement; however, all such co-owners have the right to enter
26 into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract
27 Area and they shall have the right to receive, separately, payment of the sale proceeds thereof.

28
29 E. Waiver of Rights to Partition:

30
31 If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an
32 undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided
33 interest therein.

34
35 F. Preferential Right to Purchase:

36
37 Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract
38 Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the
39 name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms
40 of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase
41 on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchas-
42 ing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing par-
43 ties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to
44 dispose of its interests by merger, reorganization, consolidation, ~~or sale of all or substantially all of its assets to a subsidiary or parent com-
**** 45 pany or to a subsidiary of a parent company,~~ or to any company in which any one party owns a majority of the stock.
46 ~~*or the sale of substantially all of its assets, or a sale or transfer of its
interests to a subsidiary or a parent company, or subsidiary of a parent company,~~

47 ARTICLE IX.

48 INTERNAL REVENUE CODE ELECTION

49
**** 50 This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association
51 for profit between or among the parties hereto. Notwithstanding any provision herein that the rights and liabilities hereunder are several
52 and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for federal income tax
53 purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded
54 from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as per-
55 mitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to ex-
56 ecute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the
57 United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements,
58 and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further
59 evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the
60 Federal Internal Revenue Service or as may be necessary to evidence this election. No such party shall give any notices or take any other
61 action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract
62 Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K", Chapter 1,
63 Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that provided by Section 761 of the Code is per-
64 mitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing elec-
65 tion, each such party states that the income derived by such party from operations hereunder can be adequately determined without the
66 computation of partnership taxable income.

Article VIII

F. Preferential Right to Purchase

If the parties wish to retain Article VIII.F., it should be revised to reflect that the preferential right to purchase shall not apply to a sale of all or substantially all of a party's assets. It is interesting to note that the preferential right to purchase provision included in the A.A.P.L. Form 610-1956 explicitly excepts from its scope the sale of all of a company's assets. In an article published in 1978, Marium L. Wigley, co-chairman of the A.A.P.L. committee who drafted the 1977 Form, compared the 1956 Form with the 1977 Form and concluded that no substantial change was made. Wigley, A.A.P.L. Model Form 610-1977 Operating Agreement, 24 Inst. of Min. L. 693, 714, (1978). One year later, Mr. Wigley in another article on the 1977 Form published a copy of the revised Model Form Operating Agreement. Wigley, A.A.P.L. Model Form Operating Agreement Proposed Revision, 26 Inst. of Min. L. 261, 307 (1979). The preferential right to purchase provision provided in this article, but not included in the A.A.P.L. Form 610-1982 is identical to the language I suggest should be incorporated. Apparently, the drafters of the 1977 Form added the words "or substantially all" and by so doing intended to expand the exception to include the sale of all or substantially all of a company's assets. Due to an apparent typographical or reproduction error, Article VIII.F. was altered and this alteration was carried forward and incorporated in the 1982 Form.

Article IX

When a Tax Partnership Agreement is attached, this provision should be deleted.

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ARTICLE X.
CLAIMS AND LAWSUITS

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

ARTICLE XI.
FORCE MAJEURE

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

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

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

ARTICLE XII.
NOTICES

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

ARTICLE XIII.
TERM OF AGREEMENT

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

- Option No. 1: So long as any of the oil and gas leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise.
- Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and/or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of _____ days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling, reworking, deepening, plugging back, testing or attempting to complete a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and/or gas from the Contract Area, this agreement shall terminate unless drilling, deepening, plugging back or reworking operations are commenced within _____ days from the date of abandonment of said well.

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

Page 13 - JOA

Article X
(Individual Loss)

In most instances, it is reasonable to insert \$10,000 in the blank. Accordingly, the Operator has the authority to settle a single uninsured claim for an amount not in excess of \$10,000. This provision does not explicitly address the situation where, as a result of a blowout or a pollution problem, a multitude of claims or suits are initiated. Does the Operator have the authority to settle 75 claims, none of which exceed \$10,000, but total \$700,000 in the aggregate? Although a literal interpretation may give the Operator authority to settle 75 single uninsured third party damage claims, none of which individually exceed \$10,000, such a result is not consistent with the purpose and intent of this provision which gives the Non-Operators the right to provide input on how to handle a problem where settlement will exceed the amount specified.

Article XI

This provision gives the party effected by a force majeure situation the discretion to handle the problem. Such party must promptly notify the other parties in writing and must act with reasonable diligence to remove the force majeure situation as quickly as practicable. During the force majeure situation, all obligations are suspended. Courts are generally not inclined to extend contracts based on claims of force majeure. To trigger the operation of a force majeure provision, a party will likely be required to prove that the event was unforeseen, that the party was without power to overcome the event, and that the event rendered performance impossible. Although these requirements are not explicitly mandated by Article XI., a court is likely to read these requirements into the JOA.

Article XII

Note that all notices must be in writing. The originating notice is effective when received. The responsive notice shall be effective when sent. It is a good practice to send notices Return Receipt Requested or some other method which will provide written evidence that a notice was sent. In appropriate circumstances, it may be advisable to send change of address notices return receipt requested or some other method which will provide written evidence that the notice was sent. Although not explicitly stated, an overnight private mail service or a courier service should meet the notice requirements. If the notice period is shortened, it would be wise to also include a home address for weekends and holidays and a telephone number. In light of the dynamic nature of the oil industry and the

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ARTICLE X.
CLAIMS AND LAWSUITS

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

ARTICLE XI.
FORCE MAJEURE

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

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

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

ARTICLE XII.
NOTICES

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

ARTICLE XIII.
TERM OF AGREEMENT

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

- Option No. 1: So long as any of the oil and gas leases subject to this agreement remain or are continued in force as to any part of the Contract Area, whether by production, extension, renewal or otherwise.
- Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled under any provision of this agreement, results in production of oil and/or gas in paying quantities, this agreement shall continue in force so long as any such well or wells produce, or are capable of production, and for an additional period of _____ days from cessation of all production; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling, reworking, deepening, plugging back, testing or attempting to complete a well or wells hereunder, this agreement shall continue in force until such operations have been completed and if production results therefrom, this agreement shall continue in force as provided herein. In the event the well described in Article VI.A., or any subsequent well drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil and/or gas from the Contract Area, this agreement shall terminate unless drilling, deepening, plugging back or reworking operations are commenced within _____ days from the date of abandonment of said well.

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

Article XII - Continued

constant movement of offices and personnel, care should be exercised to ensure that the Operator has current addresses and, if necessary, phone numbers.

Article XIII

Two options are provided. Option No. 1 would keep the Agreement alive for so long as any of the oil and gas leases remain or are continued in force as to any part of the Contract Area. Option No. 2 would continue the Agreement in effect only for so long as there is production or the well(s) is capable of production, plus a specific period of time after cessation of production. Where the parties are entering the JOA to drill a specific well, Option No. 2 is preferable. It is customary to complete the blanks on line 55 and line 61 with either "60" or "90" days, unless any subject lease has a shorter term. Where the parties are entering a JOA to jointly develop an area which may include two or more wells which have not as of yet been designated, Option No. 1 should be checked.

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ARTICLE X.
CLAIMS AND LAWSUITS

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

ARTICLE XI.
FORCE MAJEURE

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

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

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

ARTICLE XII.
NOTICES

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

ARTICLE XIII.
TERM OF AGREEMENT

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

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

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

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

Page 13 - JOA

Article X
(Joint Loss)

In most instances, it is reasonable to insert \$10,000 in the blank. Accordingly, the Operator has the authority to settle a single uninsured claim for an amount not in excess of \$10,000. This provision does not explicitly address the situation where, as a result of a blowout or a pollution problem, a multitude of claims or suits are initiated. Does the Operator have the authority to settle 75 claims, none of which exceed \$10,000, but total \$700,000 in the aggregate? Although a literal interpretation may give the Operator authority to settle 75 single uninsured third party damage claims, none of which individually exceed \$10,000, such a result is not consistent with the purpose and intent of this provision which gives the Non-Operators the right to provide input on how to handle a problem where settlement will exceed the amount specified.

Note that to transform the JOA to a joint loss agreement, the following sentence should be added to line 12: "All claims or suits involving title to any interest subject to this Agreement shall be treated as a claim or suit against all parties hereto."

Article XI

This provision gives the party affected by a force majeure situation the discretion to handle the problem. Such party must promptly notify the other parties in writing and must act with reasonable diligence to remove the force majeure situation as quickly as practicable. During the force majeure situation, all obligations are suspended.

Article XII

Note that all notices must be in writing. The originating notice is effective when received. The responsive notice shall be effective when sent. It is a good practice to send notices Return Receipt Requested or some other method which will provide written evidence that a notice was sent. If the notice period is shortened, it would be wise to also include a home address for weekends and holidays and a telephone number. In light of the dynamic nature of the oil industry and the constant movement of offices and personnel, care should be exercised to ensure that the Operator has current addresses and, if necessary, phone numbers.

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ARTICLE X.
CLAIMS AND LAWSUITS

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

ARTICLE XI.
FORCE MAJEURE

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

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

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

ARTICLE XII.
NOTICES

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ARTICLE XIII.
TERM OF AGREEMENT

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

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

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

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

Article XIII

Two options are provided. Option No. 1 would keep the Agreement alive for so long as any of the oil and gas leases remain or are continued in force as to any part of the Contract Area. Option No. 2 would continue the Agreement in effect only for so long as there is production or the well(s) is capable of production, plus a specific period of time after cessation of production. Where the parties are entering the JOA to drill a specific well, Option No. 2 is preferable. It is customary to complete the blanks on line 55 and line 61 with either "60" or "90" days, unless any subject lease has a shorter term. Where the parties are entering a JOA to jointly develop an area which may include two or more wells which have not as of yet been designated, Option No. 1 should be checked.

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ARTICLE XIV.
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

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

B. Governing Law:

This agreement and all matters pertaining hereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state of _____ shall govern.

C. Regulatory Agencies:

Nothing herein contained shall grant, or be construed to grant, Operator the right or authority to waive or release any rights, privileges, or obligations which Non-Operators may have under federal or state laws or under rules, regulations or orders promulgated under such laws in reference to oil, gas and mineral operations, including the location, operation, or production of wells, on tracts offsetting or adjacent to the Contract Area.

With respect to operations hereunder, Non-Operators agree to release Operator from any and all losses, damages, injuries, claims and causes of action arising out of, incident to or resulting directly or indirectly from Operator's interpretation or application of rules, rulings, regulations or orders of the Department of Energy or predecessor or successor agencies to the extent such interpretation or application was made in good faith. Each Non-Operator further agrees to reimburse Operator for any amounts applicable to such Non-Operator's share of production that Operator may be required to refund, rebate or pay as a result of such an incorrect interpretation or application, together with interest and penalties thereon owing by Operator as a result of such incorrect interpretation or application.

Non-Operators authorize Operator to prepare and submit such documents as may be required to be submitted to the purchaser of any crude oil sold hereunder or to any other person or entity pursuant to the requirements of the "Crude Oil Windfall Profit Tax Act of 1980", as same may be amended from time to time ("Act"), and any valid regulations or rules which may be issued by the Treasury Department from time to time pursuant to said Act. Each party hereto agrees to furnish any and all certifications or other information which is required to be furnished by said Act in a timely manner and in sufficient detail to permit compliance with said Act.

ARTICLE XV.
OTHER PROVISIONS

Article XIV

B. Governing Law

If all the acreage within the Contract Area is located in one state, there is no need to complete the blank.

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ARTICLE XIV.
COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

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

B. Governing Law:

This agreement and all matters pertaining hereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the state in which the Contract Area is located. If the Contract Area is in two or more states, the law of the state of _____ shall govern.

C. Regulatory Agencies:

Nothing herein contained shall grant, or be construed to grant, Operator the right or authority to waive or release any rights, privileges, or obligations which Non-Operators may have under federal or state laws or under rules, regulations or orders promulgated under such laws in reference to oil, gas and mineral operations, including the location, operation, or production of wells, on tracts offsetting or adjacent to the Contract Area.

With respect to operations hereunder, Non-Operators agree to release Operator from any and all losses, damages, injuries, claims and causes of action arising out of, incident to or resulting directly or indirectly from Operator's interpretation or application of rules, rulings, regulations or orders of the Department of Energy or predecessor or successor agencies to the extent such interpretation or application was made in good faith. Each Non-Operator further agrees to reimburse Operator for any amounts applicable to such Non-Operator's share of production that Operator may be required to refund, rebate or pay as a result of such an incorrect interpretation or application, together with interest and penalties thereon owing by Operator as a result of such incorrect interpretation or application.

Non-Operators authorize Operator to prepare and submit such documents as may be required to be submitted to the purchaser of any crude oil sold hereunder or to any other person or entity pursuant to the requirements of the "Crude Oil Windfall Profit Tax Act of 1980", as same may be amended from time to time ("Act"), and any valid regulations or rules which may be issued by the Treasury Department from time to time pursuant to said Act. Each party hereto agrees to furnish any and all certifications or other information which is required to be furnished by said Act in a timely manner and in sufficient detail to permit compliance with said Act.

ARTICLE XV.
OTHER PROVISIONS

Author's Note

Many JOAs do not contain Article XV. provisions. Frequently, there is no need to include any additional provisions. The suggested Article XV. provisions address specific instances where the parties wish to amend and revise the JOA or where the parties wish to supplement the JOA.

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- A. As discussed previously, it is sometimes advisable to include a "cash call" provision. The suggested language requires a party who has agreed to prepay its proportionate share of expenses to prepay or risk relinquishment of its interest in the Contract Area. The consequence of relinquishment should provide sufficient motivation for a party to meet its commitments.

Advance of Well Costs

Notwithstanding any other provisions herein, Operator shall have the right to request and receive from each Non-Operator payment in advance of its respective share of (i) the dry hole cost or (at Operator's election) the completed well cost for the initial well to be drilled under Article VI.A., and (ii) the cost of any completion, reworking, recompletion, side-tracking, deepening or plugging back operation to which such Non-Operator has consented (any such operation under clause (i) or (ii) being herein called a "Drilling Operation"). Such request for advance payment may be made upon all Non-Operators or upon any one or more of them to the exclusion of others, and shall be made in writing no earlier than thirty (30) days prior to the anticipated commencement date for such Drilling Operation. The amount of each Non-Operator's advance shall be based upon the latest AFE approved by persons participating in the Drilling Operation who own a majority of the working interest for such Operation.

A Non-Operator receiving a request for advance payment shall, within two (2) days of the receipt of such request if a drilling rig is on location and within ten (10) days of the receipt of such request in all other cases, pay to Operator in cash the full amount of such request or tender to Operator an irrevocable bank letter of credit (which shall permit partial draws) or other cash equivalent security satisfactory to Operator for the full amount due. In the event payment is in cash, Operator shall credit the amount to the Non-Operator's account for the payment of such Non-Operator's share of costs of such Drilling Operation, and following the end of each month Operator shall charge such account with such Non-Operator's share of actual costs incurred during such month.

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Payment of an advance shall in no event relieve a Non-Operator of its obligation to pay its share of the actual cost of a Drilling Operation, and when the actual costs have been determined, Operator shall adjust the accounts of the parties by refunding any net amounts due or invoicing the parties for additional sums owing, which additional sums shall be paid in accordance with the Accounting Procedure. Advance payment by a Non-Operator of his share of completed well costs shall in no event prevent such Non-Operator from electing not to participate in completion of a well pursuant to Option No. 2 of Article VII.D.1., and, in the event such a Non-Operator elects not to participate in completion, the sums which such Non-Operator has advanced shall not be charged with any share of the costs of any completion attempted.

In the event a Non-Operator from which a request for advance payment was made does not, within the time and manner above provided, fully satisfy the request for advance payment by depositing cash or furnishing a letter of credit or security as aforesaid, then Operator shall make a second written or telephonic request for such advance. Non-Operator shall pay or give security for said advance as aforesaid within two (2) days from receipt of such second request.

If a Non-Operator fails to pay or furnish the aforesaid security within two (2) days of the receipt of such second request, then:

1. If the advance was requested for the drilling of the initial well under Article VI.A., Non-Operator shall be deemed to have relinquished and shall assign all of its leasehold and contract rights in the Contract Area, within thirty (30) days of a request for such assignment, to those parties who have participated in such Drilling Operation, in proportion that such parties elected to share the relinquished interest.

2. If the advance was requested for any other Drilling Operation involving the initial well drilled pursuant to Article VI.A. (including completion of the initial well), Non-Operator shall be deemed to have relinquished an interest in the well to which the Drilling Operation

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relates computed in the same manner and with the same force and effect as if such Non-Operator had originally elected under Article VI.B.2. (and, if applicable, Option No. 2 of Article VII.D.1.) not to participate in such Operation.

Notwithstanding anything to the contrary, Operator shall have the right to sue a Non-Operator who failed to pay or furnish the aforesaid security as provided above for its proportionate share of expenses, in lieu of an assignment of all Non-Operator's leasehold and contract rights within the Contract Area or in lieu of obtaining a non-consent penalty as provided for in Article VI.B.2.

If the Non-Operator fails to make such payment or furnish such security within two (2) days of the receipt of such second request, Operator shall promptly notify all other parties still participating in such Drilling Operation of the relinquishment of an interest under this provision. The parties who wish to participate in the Drilling Operation shall have five (5) days from receipt of such notice to elect to assume the costs chargeable to such relinquished interest and shall share such relinquished interest, in proportion to their assumption of such relinquished interest. If the parties who wish to participate in the Drilling Operation are unwilling to assume the costs chargeable to such relinquished interest, the Drilling Operation shall be cancelled, and if the cancelled Drilling Operation involves the drilling of a test well under Article VI.A., no assignment shall be due as a consequences of the failure to pay or furnish the aforesaid security as provided above.

In appropriate circumstances, subparagraph 1 (above) could be replaced with the following or some variation thereof:

If the advance was requested for the drilling of the initial test well under Article VI.A., Non-Operator shall be deemed to relinquish all such Non-Operator's interest in the drilling and spacing unit applicable to such well from the surface of the ground down to one hundred (100) feet below the stratigraphic equivalent of the total depth drilled.

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- B. The following "cash call" provision requires advances for both exploration and development wells and provides that the Operator shall credit a depositing Non-Operator with interest at the rate of 5% per annum.

Advance of Well Costs

Notwithstanding any other provisions herein, Operator shall have the right to request and receive from each Non-Operator payment in advance of its respective share of (i) the dry hole cost or (at Operator's election) the completed well cost for the initial well to be drilled under Article VI.A., (ii) the dry hole cost or (at Operator's election) the completed well cost for any other well to be drilled hereunder to which such Non-Operator has consented, and (iii) the cost of any completion, reworking, recompletion, sidetracking, deepening or plugging back operation to which such Non-Operator has consented (any such operation under clause (i), (ii) or (iii) being herein called a "Drilling Operation"). Such request for advance payment may be made upon all Non-Operators or upon any one or more of them to the exclusion of others, and shall be made in writing no earlier than thirty (30) days prior to the anticipated commencement date for such Drilling Operation. The amount of each Non-Operator's advance shall be based upon the latest AFE approved by persons participating in the Drilling Operation who own a majority of the working interest for such Operation.

A Non-Operator receiving a request for advance payment shall, within two (2) days of the receipt of such request if a drilling rig is on location and within ten (10) days of the receipt of such request in all other cases, pay to Operator in cash the full amount of such request or tender to Operator an irrevocable bank letter of credit (which shall permit partial draws) or other cash equivalent security satisfactory to Operator for the full amount due. In the event payment is in cash, Operator shall credit the amount to the Non-Operator's account for the payment of such Non-Operator's share of costs of such Drilling Operation, and following the end of each month Operator shall charge such account with such Non-Operator's share of actual costs incurred during such month. Further, at the end of each month following such deposit, Operator shall credit a

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depositing Non-Operator with interest on the funds on deposit during such month at the rate of five (5) percent per annum, and for determining the amount of interest to be credited a Non-Operator's share of costs for such month shall be deemed to have been charged to such account on the last day of the month even though actual withdrawal of funds occurs at a later date.

Payment of an advance shall in no event relieve a Non-Operator of its obligation to pay its share of the actual cost of a Drilling Operation, and when the actual costs have been determined, Operator shall adjust the accounts of the parties by refunding any net amounts due or invoicing the parties for additional sums owing, which additional sums shall be paid in accordance with the Accounting Procedure. Advance payment by a Non-Operator of his share of completed well costs shall in no event prevent such Non-Operator from electing not to participate in completion of a well pursuant to Option No. 2 of Article VII.D.1., and, in the event such a Non-Operator elects not to participate in completion, the sums which such Non-Operator has advanced shall not be charged with any share of the costs of any completion attempted.

In the event a Non-Operator from which a request for advance payment was made does not, within the time and manner above provided, fully satisfy the request for advance payment by depositing cash or furnishing a letter of credit or security as aforesaid, then Operator shall make a second written or telephonic request for such advance. Non-Operator shall pay or give security for said advance as aforesaid within two (2) days from receipt of such second request.

If a Non-Operator fails to pay or furnish the aforesaid security within two (2) days of the receipt of such second request, then:

1. If the advance was requested for the drilling of the initial well under Article VI.A., Non-Operator shall be deemed to have relinquished and shall assign all of its leasehold and contract rights in the Contract Area, within thirty (30) days of a request for such

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assignment, to those parties who have participated in such Drilling Operation, in proportion that such parties elected to share the relinquished interest.

2. If the advance was requested for any other Drilling Operation (including completion of the initial well), Non-Operator shall be deemed to have relinquished an interest in the well to which the Drilling Operation relates computed in the same manner and with the same force and effect as if such Non-Operator had originally elected under Article VI.B.2. (and, if applicable, Option No. 2 of Article VII.D.1.) not to participate in such Operation.

Notwithstanding anything to the contrary, Operator shall have the right to sue a Non-Operator who failed to pay or furnish the aforesaid security as provided above for its proportionate share of expenses, in lieu of an assignment of all Non-Operator's leasehold and contract rights within the Contract Area or in lieu of obtaining a non-consent penalty as provided for in Article VI.B.2.

If the Non-Operator fails to make such payment or furnish such security within two (2) days of the receipt of such second request, Operator shall promptly notify all other parties still participating in such Drilling Operation of the relinquishment of an interest under this provision. The parties who wish to participate in the Drilling Operation shall have five (5) days from receipt of such notice to elect to assume the costs chargeable to such relinquished interest and shall share such relinquished interest, in proportion to their assumption of such relinquished interest. If the parties who wish to participate in the Drilling Operation are unwilling to assume the costs chargeable to such relinquished interest, the Drilling Operation shall be cancelled, and if the cancelled Drilling Operation involves the drilling of a test well under Article VI.A., no assignment shall be due as a consequences of the failure to pay or furnish the aforesaid security as provided above.

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- C. In lieu of a "cash call" provision, the parties could utilize an escrow agreement to ensure timely payment. A variation of the below Escrow Agreement could be attached to the JOA.

ESCROW AGREEMENT

STATE OF _____ §
 COUNTY OF _____ §

WHEREAS, _____,
 (hereinafter "First Party") and _____
 _____, hereinafter "Second Party") are
 parties to an Agreement dated _____,
 198____, wherein First Party agreed to deposit in escrow on or
 before _____, 19____, its share of
 the AFE cost for the drilling of the _____
 _____ Well.

NOW, THEREFORE, in consideration of the foregoing it is agreed by the undersigned parties and Escrow Agent as follows:

1. On or before _____, 198____, First Party shall deposit or shall wire funds in the amount of _____, made payable to Escrow Agent.

2. All escrow funds received by the Escrow Agent may be invested in certificates of deposit, repurchase agreements, or such other short term investments as First Party shall advise Escrow Agent in writing. Escrow Agent shall not be liable for losses on any investments made by it pursuant to and in compliance with such instructions.

3. Escrow Agent is to hold said escrow funds paid into the escrow account under the terms hereof. Second Party shall monthly furnish Escrow Agent with a joint billing statement. Escrow Agent shall, within ten (10) business days from receipt of a joint billing statement, forward the amount specified directly to Second Party out of escrow funds.

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4. Escrow Agent shall monthly forward to the undersigned parties a summary of all joint interest billings.

5. In the event First Party elects to participate in any completion attempt, it shall deposit _____ within _____ within two (2) business days after such election. Failure to deposit this sum within two (2) business days of its election to participate in the completion attempt shall be deemed an election by First Party to not participate in the completion attempt. The procedure for the payment of completion expenses shall be identical to the procedure herein provided for the payment of drilling expenses.

6. In the event the escrow funds are not fully disbursed, the undersigned parties shall notify Escrow Agent that the remaining Escrow Funds plus accrued interest shall be paid to First Party as directed by instructions executed by both parties.

In the handling of the above listed items and in determining the disposition to be made thereof, Escrow Agent shall be governed entirely by these instructions and shall not be responsible for the validity, sufficiency or legality of any of the said items. Escrow Agent is authorized to act on written authority from an attorney-in-fact, provided written evidence of authority is first furnished to the Escrow Agent or any officer of the undersigned parties or its parent, of the level of Vice President or higher. The Escrow Agent is hereby authorized and directed to deliver the subject matter of the escrow to First Party in accordance with the written instructions of the undersigned parties.

Where directions or instructions from more than one of the undersigned are required, such directions or instructions may be given by separate instruments of similar tenor.

It is further agreed by the undersigned that:

- a. The Escrow Agent is not a party to, is not bound by, or charged with notice of any other agreement out of which this escrow may arise.

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b. The Escrow Agent acts hereunder as a depository only, and is not responsible or liable in any manner whatsoever for the sufficiency, correctness, genuineness or validity of the subject matter of the escrow, or any part thereof, does not warrant title or validity of the funds or of the genuineness of the signatures, or for the form of execution thereof, or for the identity of authority of any person acting on behalf of any party hereunder.

c. In the event the Escrow Agent becomes involved in litigation in connection with this escrow, all of the other parties hereto agree, jointly and severally, to indemnify and save the Escrow Agent harmless from all loss, costs, damages, expenses and reasonable attorneys' fees suffered or incurred by the Escrow Agent as a result thereof. The obligation of the said other parties under this paragraph shall be performable at the office of the Escrow Agent in Los Angeles, California.

d. The Escrow Agent shall be protected in acting upon written notice, request, waiver, consent, certificate receipt, authorization, power of attorney or other paper or document which the Escrow Agent, in good faith, believes to be genuine and what it purports to be.

e. The Escrow Agent shall not be liable for anything which it may do or refrain from doing in connection herewith, provided that it acts in good faith.

f. The Escrow Agent may consult with legal counsel in the event of any dispute or question as to the construction of any of the provisions hereof or its duties hereunder, and it shall incur no liability and shall be fully protected in acting in accordance with the opinion and instructions of such counsel.

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g. In the event of any disagreement between any of the parties of this Agreement or between them or any of them and any other person, resulting in adverse claims or demands being made in connection with the subject matter of this escrow, or in the event that the Escrow Agent, in good faith, shall be in doubt as to what action it should take thereunder, the Escrow Agent may, at its option, refuse to comply with any claims or demands on it, or refuse to take any other action hereunder, so long as such disagreement continues or such doubt exists, and in any event, the Escrow Agent shall not be or become liable in any way or to any person for its failure of refusal to act, and the Escrow Agent shall be entitled to continue so to refrain from acting until (i) the rights of all parties shall have been fully and finally adjudicated by a court of competent jurisdiction, or (ii) all differences shall have been adjusted and all doubt resolved by agreement among all of the interested persons, and the Escrow Agent shall have been notified thereof in writing signed by all such persons. The rights of the Escrow Agent under this paragraph are cumulative of all other rights which it may have by law or otherwise.

h. Escrow Agent shall not be liable for any act or thing done or caused to be done by it pertaining to this Escrow Agreement, except for gross negligence or willful misconduct.

i. The parties agree to indemnify, defend and hold the Escrow Agent harmless from and against any and all loss, damage, tax, liability and expense that may be incurred by the Escrow Agent arising out of or in connection with its acceptance of appointment as Escrow Agent hereunder, including the legal costs and expenses of defending itself against any claim or liability in connection with its performance hereunder.

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j. This Escrow Agreement shall be governed by and construed in accordance with the laws of the State of _____.

Escrow Agent will be paid according to their regular schedule of fees for acting as Escrow Agent hereunder by First Party.

This Escrow Agreement has been executed on the dates set forth opposite the respective signatures of the parties hereto.

DATE: _____

By: _____

Name: _____

Title: _____

DATE: _____

By: _____

Name: _____

Title: _____

The undersigned bank as Escrow Agent hereby acknowledges receipt of the items described above and agrees to hold, deal with, and dispose of them in accordance with the foregoing instrument as amended.

BANK

By: _____

Name: _____

Title: _____

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The Escrow Agreement could be prepared to secure the payment of only one party. Additionally, the Agreement could be drafted to require the full payment into escrow of both drilling and completion costs. Alternatively, the Escrow Agreement could provide that in the event a party fails to make a timely escrow deposit to cover its proportionate share of completion costs, it shall be considered to have elected to go non-consent under Article VI.B. of the JOA or to have relinquished or forfeited its interest under some other provision of the JOA. Finally, the Escrow Agreement could be drafted to require that all the parties approve the payment of invoices, in the event the Non-Operators wish to ensure that the invoices are being properly paid.

- D. The following provision will act to discourage a party from avoiding the timely payment of its proportionate expenses:

Rights Of Operator Against A Defaulting Party:

Notwithstanding anything to the contrary contained in Article VII.B., in the course of conducting drilling, reworking, deepening, testing, completing or plugging back operations in a well on the Contract Area, if any party fails or is unable to pay its proportionate share of the costs for such operation, Operator shall have the right to enforce the lien as provided in Article VII.B. herein, or Operator shall have the right, to be exercised before or after completion of such operation after thirty (30) days prior written notice of such intention is given to the defaulting party, to treat such defaulting party as having made a non-consent election and being subject to the non-consent provisions provided in Article VI.B.2., effective as of when such party defaulted in payment of its bills, unless the defaulting party pays such bills in full within said thirty (30) day period; however, the penalty amounts provided for in Article VI.B.2.(b) shall be 500%. If Operator elects to treat the defaulting party as having made a non-consent election, Operator may not enforce the lien as provided in Article VII.B. herein. If the defaulting party is the Operator, the Non-Operator(s) shall select a new Operator pursuant to Article V.B.2.

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Notwithstanding anything to the contrary contained herein, if the lien provided for in Article VII.B. has been enforced, for so long as the affected party remains in default, it shall have no further access to the Contract Area or information obtained in connection with operations hereunder and shall not be entitled to vote on any matter hereunder. As to any proposed operation in which it otherwise would have the right to participate, such party shall have the right to be a Consenting Party herein only if it pays the amount it is in default before the operation is commenced; otherwise, it automatically shall be deemed a Non-Consenting Party to that operation. If the defaulting party is the Operator, the Non-Operator(s) shall select a new Operator pursuant to Article V.B.2.

- E. Occasionally, the parties wish to adopt a forfeiture or obligatory well provision. These provisions provide that if drilling operations are necessary to maintain a lease or earn a lease, only those parties who participate in such operations shall own or earn an interest in the lease. The non-consent penalty in Article VI.B.2. will not be applicable to such situations. The following language is recommended:

Obligatory Well

Notwithstanding the provisions of this Agreement and particularly Article VI., if any proposed operations are necessary to either maintain a lease covered by this Agreement in force or to earn a lease or part thereof under an agreement which would otherwise expire unless such operations are conducted, then in lieu of being penalized under Article VI.B.2.(a) and (b), each Non-Consenting Party shall assign to Consenting Parties all of such Non-Consenting Party's right, title and interest in and to the lease or portion thereof or such agreement which would be lost or not earned if such operations were not conducted.

Such assignment shall be promptly due upon commencement of said proposed operations by Consenting Parties and shall be free and clear of all overriding royalties, production payments, mortgages, liens and other burdens and encumbrances placed thereon by the assigning party or resulting from its ownership or operation of such lease or interest which is not a joint obligation of the parties, but otherwise without warranty of title either expressed or implied.

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If the assignment is in favor of more than one party, the assigned interest shall be shared by the Consenting Parties in the proportions that the interest of each bears to the interest of all Consenting Parties unless otherwise agreed to in writing. Thereafter, such acreage covered by said assignment shall not be subject to the terms of this Agreement but shall be deemed to be subject to an agreement identical to this Agreement, except that Exhibit "A" shall be revised to reflect the Consenting Parties and their percentages of interest.

Operations that are necessary to either maintain a lease covered by this Agreement in force or to earn a lease or part thereof under an agreement which would otherwise expire unless operations are conducted, shall be defined as operations that are proposed within six (6) months of the date the lease or agreement would otherwise expire.

One or more of the parties to this Agreement can avoid the application of this provision by extending or renewing a lease covered by this Agreement or by extending or renewing an agreement to earn a lease or part thereof. Such extension or renewal shall be secured prior to the running of the time period described in Article VI.B.1. If the extension or renewal of the lease or the agreement imposes additional burdens, these additional burdens shall be assumed by the party or parties who have secured the extension or renewal.

F. Obligatory Well

Notwithstanding the provisions of this Agreement and particularly Article VI, if any proposed operations are necessary to maintain a lease covered by this Agreement in force or an agreement to earn a lease(s) which would otherwise expire unless such operations are conducted, then in lieu of being penalized under Article VI.B.2.(a) and (b), each Non-Consenting Party shall assign to Consenting Parties all of such Non-Consenting Party's right, title and interest in and to the lease(s) or portion thereof or such Agreement which would be lost or not earned if such operations were not conducted. Such assignment shall be promptly due upon commencement of said proposed operations by Consenting Parties, and if the

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assignment is in favor of more than one party, the assigned interest shall be shared by the Consenting Parties in the proportions that the interest of each bears to the interest of all Consenting Parties unless otherwise agreed to in writing. Thereafter, such acreage covered by said assignment shall not be subject to the terms of this Agreement, but shall be deemed to be subject to an agreement identical to this changed only in Exhibit "A" to indicate the Consenting Parties and their percentages of interest. For purposes of defining necessary operations to maintain a lease or agreement to earn a lease(s) in force which would otherwise expire, such operations will be deemed necessary if proposed within six (6) months of the date the lease or agreement would otherwise expire.

- G. The Blackout provisions below provide powerful incentives for a party to seriously consider participating in a well.

Blackout Provision

Notwithstanding anything to the contrary, any party may, at any time propose that the parties drill an initial test well on a proposed Drilling Unit. As used in this agreement, "Drilling Unit" means the lands subject to a jointly owned oil and gas lease or leases within an area embracing approximately one hundred and sixty (160) gross acres with the bottom hole location of the well at its center.

The party proposing a well, shall deliver an executed AFE to the other parties. The non-proposing parties shall have thirty (30) days from receipt of said AFE to return an executed copy thereof to the party proposing the well indicating its desire to participate in said well. Failure of any non-proposing party to timely return an executed AFE shall be deemed an election not to participate.

Any party electing not to participate in an exploratory well, which shall be defined as a well which the bottom hole location is more than one (1) mile (radius) away from the bottom hole location of a producing well, shall, after the exploratory well has been drilled, relinquish to the drilling party or parties all its interest in the eight (8) one hundred and sixty (160) acre tracts directly and diagonally offsetting the Drilling Unit.

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Blackout Provision

Notwithstanding anything to the contrary, in the event that any party hereto elects not to participate in the drilling of a well proposed under Article VI.B.1. on the prospect acreage subject to this Agreement, that party shall promptly assign upon commencement of said proposed operation to the parties electing to drill said exploratory well one hundred (100) percent of its right, title and interest in the drillsite eighty (80) acre tract and the eight (8) contiguous and diagonally contiguous eighty acre tracts. The relinquished tracts shall comprise a block of seven hundred and twenty (720) acres in the form of a square around the proposed exploratory well.

- H. The parties to a JOA could elect to replace the non-consent provisions which would apply to a proposal to drill a well with the below farmout provision. Any party who elects not to participate would contractually agree to farmout its interest to the participating parties.

Farmout

If any party receiving a notice proposing to drill a well as provided in Article VI.B.1. elects not to participate in the proposed operation, then, in order to be entitled to the benefits of this Article, the party or parties giving the notice and other parties as shall elect to participate in the operation shall within ninety (90) days after the expiration of the thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period when a drilling rig is on location, as the case may be) actually commence the proposed drilling operation and complete it with due diligence. Operator shall perform all work for the account of the Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Operator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (b) designate one of the Consenting Parties as Operator to perform such work. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article, shall comply with all the terms and conditions of this Agreement.

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If less than all parties approved any proposed drilling operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise the Consenting Parties of the total interest of the parties approving such operation and its recommendation as to whether the Consenting Parties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48) hours after receipt of such notice, shall advise the proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A" or (b) carry its proportionate part of Non-Consenting Parties' interest, and failure to advise the proposing party shall be deemed an election under (a). In the event a drilling rig is on location, the time permitted for such a response shall not exceed a total of forty-eight (48) hours (inclusive of Saturday, Sunday and legal holidays). The proposing party, as its election, may withdraw such proposal if there is insufficient participation and shall promptly notify all parties of such decision.

The entire cost and risk of conducting such drilling operations shall be borne by the Consenting Parties in the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting Parties shall keep the leasehold estates involved in such operations free and clear of all liens and encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such an operation results in a dry hole, the Consenting Parties shall plug and abandon the well and restore the surface location at their sole cost, risk and expense. If any well drilled under provisions of this Article results in a producer of oil and or gas in paying quantities, the Consenting Parties shall complete and equip the well to produce at their sole cost and expense and the well shall be turned over the Operator and shall be operated by it at the expense and for the account of the Consenting Parties.

Upon commencement of operations for the drilling of any well by the Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have farmed out to Consenting Parties, in proportion to Consenting Parties' respective interests, all of the Non-Consenting Party's right, title and interest in and to the well, the leases covering the lands included within the

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spacing unit for the well and its share of production from the well, but shall reserve and retain an overriding royalty interest in all oil, gas and other minerals produced, saved and sold from the well equal to the difference between _____ (_____) percent and the base lease royalties and all other burdens of record as of the date of this Agreement, until payout. Such overriding royalty interest shall be in addition to presently effective royalties, overriding royalties, production payments, if any, and shall be free and clear of all costs except ad valorem, production and severance taxes assessed thereon. Said overriding royalty interest, and the working interest to which it may be converted as hereinafter described, shall be proportionately reduced and shall be payable in the proportion that the Non-Consenting Party's interest in the leases covering the lands contained within the spacing unit for the producing well bears to the entire mineral interest.

After the well has been drilled to the proposed depth and completed as a well capable of production, and upon receipt of a written request from Consenting Parties, each Non-Consenting Party shall execute and deliver to the Consenting Parties an assignment conveying to the Consenting Parties all of each Non-Consenting Party's right, title and interest in and to the well, the leases covering the lands included within the spacing unit for the well and its share of production from the well, from the surface of the ground down to one hundred (100) feet below the stratigraphic equivalent of the total depth drilled in the well. Each Non-Consenting Party shall except from such assignment and reserve and retain unto themselves its overriding royalty interest.

If the well is plugged and abandoned as a dry hole, and upon receipt of a written request from the Consenting Parties, each Non-Consenting Party shall execute and deliver to the Consenting Parties an assignment conveying _____ (_____) percent of each Non-Consenting Party's right, title and interest in and to the well and the leases covering the lands included within the spacing unit for the well, from the surface of the ground down to one hundred (100) feet below the stratigraphic equivalent of the total depth drilled in the well.

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At payout of the well, the Consenting Parties shall notify each Non-Consenting Party of such occurrence and each Non-Consenting Party, shall, within thirty (30) days of such notice, notify the Consenting Parties by written communication of its election to proceed under either Option No. 1 or Option No. 2, below. Failure of each Non-Consenting Party to so elect shall be considered an election to proceed under Option No. 2, below.

1. Non-Consenting party elects to convert its overriding royalty interest to a proportionately reduced _____ () working interest in the well, the production therefrom, and the leases covering the lands contained in the spacing unit for the well. Said election to be effective the day following the day payout occurs. The Consenting Parties, within thirty (30) days of each Non-Consenting Party's election, shall execute and deliver to each Non-Consenting Party an assignment conveying such interest.
2. Non-Consenting Party elects to retain the overriding royalty retained herein.

For the purposes of the Article, payout for any well shall be deemed to occur when the cumulative market value of production from the well (after deducting severance and production taxes paid by the Consenting Parties, plus any royalties, overriding royalties, production payments and similar lease burdens existing as of this date or reserved by the Non-Consenting Party) shall equal one hundred (100) percent of the actual cost of drilling, testing and completing the well (including the actual cost of any reworking, deepening or plugging back), plus one hundred (100) percent of the actual cost of operating the well during the payout period.

[The adoption of the above farmout provision necessitates the revision of the Article VI.B., so that it only applies to proposals to rework, deepen or plug back. To accomplish this (1) delete the words "such notice" on line 34, page 5 and replace with "a notice proposing to rework, deepen or plug back a dry hole," (2) delete the word "proposed" on line 47, page 5 and insert "proposal to rework, deepen or plug

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back," (3) delete the word "drilled" in line 62, page 5, (4) delete the word "drilling" or the on line 21 and 55, (5) delete the words "drilling or the" on line 28, page 6, (6) after the first paragraph on page 7, state "The above shall not be applicable to operations conducted in accordance with the farmout provision in Article XV. _____."]

- I. Non-Operators occasionally seek to include provisions which provide that a Non-Operator can take over as Operator if it is willing to operate at a cost which is less than the current Operator is charging and the current Operator does not elect to reduce its costs to the level proposed by the Non-Operator. Below find two such provisions.

Change of Operator

Anything herein to the contrary notwithstanding and after twelve (12) months from the date of completion of the test well provided for in Article VI.A., if any Non-Operating Party hereto who is regularly engaged in the oil and gas business considers that the cost of operating the Contract Area is excessive and said party is willing to operate the premises as efficiently and effectively at a cost of at least fifteen (15) percent less than the cost which the premises are being operated by the party who is then acting as Operator, such Non-Operating Party may notify Operator and all other Non-Operators that it can and will operate the premises at less cost and shall set forth in such notice each of the charges said party deems to be excessive and shall also itemize and set forth the charges at which said party proposes to operate the premises. [Optional - In addition, this notification shall include a statement executed by an authorized agent or representative of at least one (1) additional party to this Agreement, other than a party which is related to or affiliated with the proposing Non-Operating Party supporting and ratifying the proposal to operate. The proposing Non-Operating Party and the supporting party shall own a combined working interest in the Contract Area equal to or greater than twenty (20) percent.] Within thirty (30) days from the receipt of such notice, Operator shall reply to the Non-Operator from whom the notice was received, giving copies of its reply to all other Non-Operators, and shall agree to operate the premises at such specified charge or shall relinquish operations to the Non-Operating Party who gave notice,

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which party shall then be and become Operator hereunder.

The Successor Operator shall be bound by such specified charges and such statement of savings and operating cost. Thereafter, and in like manner, such Operator or any Successor Operator may be changed after the lapse of twelve (12) months from the date on which any Successor Operator took over operation of the premises. The provisions of Article V.B. shall apply to any such change of Operator except Successor Operator shall not be entitled to resign as Operator until the completion of twelve (12) months from the date on which Successor Operator took over the operation of the premises without the consent of all parties.

In the same manner, in the event a test or other operation is proposed according to the provisions of Article VI.B.1. in the Contract Area, if any Non-Operating Party hereto who is regularly engaged in the oil and gas business considers that the proposed cost of drilling, completing and or equipping the test well is excessive, and said party is willing to drill, complete and or equip the proposed test well at a cost of at least fifteen (15) percent less than the cost which the Operator has proposed, such Non-Operating Party may notify Operator and all other Non-Operators that it can and will drill, complete and or equip at less cost and shall set forth in such notice each of said charges said party proposes to drill, complete and or equip said test well. [Optional - In addition, this notification shall include a statement executed by an authorized agent or representative of at least one (1) additional party to this Agreement, other than a party which is related to or affiliated with the proposing Non-Operating Party. The proposing Non-Operating Party and the supporting party shall own a combined working interest in the Contract Area equal to or greater than twenty (20) percent.] Within ten (10) days from the receipt of such notice, Operator shall reply to the Non-Operator from whom the notice was received, giving copies of its reply to all other Non-Operators, and shall agree to drill, complete and or equip the test well at such specified charge or shall relinquish operations for such drilling, completing and or equipping to the Non-Operating Party who gave notice, which party shall then be and become Operator for the drilling, completing and or equipping of the test well.

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The Successor Operator shall be bound by such specified charges and such statements of savings for the operations contemplated. The Successor Operator shall not be bound to such specified charges and statements of savings, however, as to any additional charges necessitated by the encountering of granite or other practically impenetrable substance or in the event of lost circulation, loss of the hole, re-drilling of the hole, change in proposed operation, or by reason of scarcity of or inability to obtain or use labor, water, equipment or material (including drilling rig), strikes or differences with workmen, failure of carriers to transport or furnish facilities for transportation, wars, fires, storms, storm warnings, floods, riots, epidemics, compliance with or obedience to any Federal or State law or any regulation, rule or order of any governmental authority having jurisdiction, force majeure, or any cause whatsoever (other than financial), beyond its control, whether similar or dissimilar. Upon completion by Successor Operator of all drilling, completing, and or equipping and testing operations on the test well, Successor Operator, shall have the right but not the obligation to relinquish the well to the Operator of the Contract Area for purposes of operating the well.

Notwithstanding the provisions of Article VI.B.2. or any other provisions to the contrary, should any Non-Operator (Successor Operator) assume operations of any well in the Contract Area for purposes of drilling, testing, evaluating, completing, equipping or operating such well and Successor Operator completes such well as a producing well, then Successor Operator shall have the right but not the obligation to turn the well over to Operator for purposes of operating such well.

In the event of a change of Operator for any reason, operations shall nevertheless be conducted in accordance with good oil field practice at all times as would be conducted by a reasonably prudent Operator under the same or similar circumstances and Operator shall promptly deliver to Successor Operator all records and information necessary for Successor Operator to discharge its duties and obligations as Operator.

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Change of Operator

Notwithstanding the provisions of Article V.B., at any time after Operator has been acting hereunder for a period of two (2) years from the date on which it was originally designated Operator, any Non-Operator may notify Operator in writing of more cost efficient terms under which the Non-Operator would be prepared to act as Operator. Unless within thirty (30) days from receipt of such notice Operator agrees in writing to continue to act as Operator on the terms outlined by the Non-Operator, said Non-Operator shall become Operator on the said terms at the end of the thirty (30) days following the end of said thirty (30) day period. Similarly, at any time after the new Operator has been acting as Operator hereunder for a period of two (2) years, any Non-Operator may notify Operator in writing of the terms under which such Non-Operator would be prepared to act as Operator, and unless, within thirty (30) days from receipt of such notice, Operator agrees in writing to continue to act as Operator on the terms outlined by said Non-Operator, such Non-Operator shall become Operator on the same terms at the end of the thirty (30) days following the end of said thirty (30) day period. If a change of Operator occurs under this paragraph or under Article V.B., the retiring Operator shall promptly deliver to the Successor Operator all records and information necessary for Successor Operator to discharge its duties and obligations as Operator.

- J. There is a wide divergence of opinion in the industry with regard to the use of priority of operations or sequence of operation provision. One school of thought holds that to avoid future conflict, the parties should reach an agreement before the well is commenced on the timing of future operations. The other school of thought believes that an intelligent decision on the timing of future operations can only be made when the parties can analyze the well information for a specific well and that decisions made beforehand in a vacuum only constrain intelligent operations and are not in the best interest of the parties.

Priority of Operations

Where a well authorized under the terms of this Agreement by all parties, (or by less than all parties

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under Article VI.B.2.) has been drilled to the Objective Depth and the parties participating in the well cannot agree upon the sequence and timing of further operations regarding such well, the following elections shall control in the order enumerated below:

1. An election to do additional logging, coring or testing;
2. An election to attempt to complete the well;
3. An election to plug back and attempt to complete said well at a shallower formation;
4. An election to deepen said well; and
5. An election to sidetrack the well.

However, if at any time the participating parties are considering the above elections, the hole is in such a condition that in the opinion of a majority of the parties a reasonably prudent operator would not conduct the operations contemplated by the particular election involved because of the possibility of placing the hole in jeopardy or losing the same prior to completing the well, such election shall not be given the priority hereinabove set forth. Instead, the operation which is less likely to jeopardize the well in the opinion of the majority on an interest basis of parties entitled to participate in the operation will be conducted. It is further understood that if some, but not all, parties elect to participate in the additional logging, coring or testing, they may do so and the party or parties not logging, coring or testing shall not be entitled to the logs, cores, or the results of the tests but shall suffer no other penalty.

- K. As discussed herein, lands that are initially subject to the JOA may be excluded from the JOA. To avoid potentially prolonged negotiations over the adoption of an Operating Agreement, the parties could insert the following provision which provides that lands that are no longer covered by the JOA and owned by two or more parties shall be governed by an identical Operating Agreement.

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Lands Excluded from the JOA

In the event that lands covered by a lease or a portion thereof which were initially subject to this Agreement; but in accordance with the terms hereof are no longer subject to this Agreement, and such lands are acquired by one or more parties to this Agreement, such leasehold or contract rights and the leasehold covered thereby shall be governed by an Operating Agreement identical to this Agreement, except that the Operating Agreement shall be revised to reflect the parties thereto and their percentage ownership, the Contract Area and the Operator, if different.

- L. To avoid multiple well proposals pursuant to Article VI., the following provision could be incorporated:

Well Proposal

It is specifically provided that no notice shall be given under Article VI. hereof which proposes the drilling of more than one well. Further, the provisions of Article VI., insofar as same pertain to notification by a party of its desire to drill a well, shall be suspended for so long as (i) a prior notice has been given which is still in force and effect and the period of time during which the well regarding same may be commenced has not expired, or (ii) a well is then being drilled hereunder. This paragraph shall not apply under those circumstances where the well to which notice is directed is a well which is required under the terms of a lease or contract or one required to maintain a lease or portion thereof in force.

- M. If the parties enter into a JOA which encompasses open acreage, the parties may wish to include an Area of Mutual Interest or "AMI". Such AMI should provide that all acreage acquired by the parties in the proportions designated in Exhibit "A" shall be included within the Contract Area and shall be governed by the JOA. Acreage that is not acquired in the proportions designated in Exhibit "A" shall be excluded from the Contract Area and shall not be governed by the JOA. I recommend a derivation of the following:

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Area of Mutual Interest

A. The parties hereto hereby create an Area of Mutual Interest ("AMI") comprising the Contract Area. This AMI shall remain in force and effect as long as this Operating Agreement remains in effect, unless sooner terminated by the parties.

B. During the term of this AMI, if any party hereto ("Acquiring Party") acquires any oil and gas leases or any interest therein, any unleased mineral interest or any farmouts or other contracts with respect thereto which affect lands and minerals lying within the AMI ("Mineral Interest"), the Acquiring Party shall promptly advise each of the other parties hereto ("Offeree") of such acquisition. In such event, each Offeree shall have the right to acquire its proportionate interest in such Mineral Interest in accordance with the other provisions of this AMI.

C. Promptly upon acquiring such Mineral Interest, the Acquiring Party shall, in writing, advise the Offerees of such acquisition. The notice shall include a copy of all instruments of acquisition including, by way of example but not of limitation, copies of the leases, assignments, subleases, farmouts or other contracts affecting the Mineral Interest. The Acquiring Party shall also enclose an itemized statement of the actual costs and expenses incurred by the Acquiring Party in acquiring such Mineral Interest, excluding, however, costs and expenses of its own personnel ("Acquisition Costs"). Each Offeree shall have a period of fifteen (15) days after receipt of the notice within which to furnish the Acquiring Party written notice of its election to acquire its proportionate interest in the offered Mineral Interest. If, however, a well in search of oil or gas is being drilled the AMI or at a location outside the AMI of which the result could be expected to materially affect the value of the offered Mineral Interest, each Offeree shall have a period of forty-eight (48) hours after receipt of the notice within which to elect to acquire its proportionate interest in the Mineral Interest so offered. It is provided, however, that the forty-eight (48) hour election period shall not apply unless the Acquiring Party shall give the notice to the Offerees within two (2) days after the date on which the Acquiring Party

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acquired the Mineral Interest so offered. In addition thereto, the Acquiring Party shall also:

- (i) furnish the Offeree with the approximate location of the well then being drilled and the name of the Operator or drilling contractor drilling the well, and
- (ii) specifically advise the Offeree that the Offeree shall have a period of forty-eight (48) hours within which to elect to acquire an interest in the offered Mineral Interest.

The above information shall be in addition to the information and copies of instruments provided for above in connection with the usual notices of acquisition of a Mineral Interest. If the Acquiring Party shall not have received actual written notice of the election of the Offeree to acquire its proportionate interest within the fifteen (15) day or forty-eight (48) hour period, as the case may be, such failure shall constitute an election by such Offeree not to acquire its interest in the Mineral Interest. Each Offeree accepting the offered Mineral Interest shall be entitled to participate in such Mineral Interest in the proportion to which its interest in the AMI bears to the aggregate interest in the AMI of the Acquiring Party and all other Offerees who have elected to acquire an interest in the Mineral Interest so offered. Promptly after the expiration of the election period, the Acquiring Party shall invoice each Offeree electing to acquire an interest for its proportionate part of the Acquisition Costs. Each Offeree shall immediately reimburse the Acquiring Party for its share of the Acquisition Costs, as reflected by the invoice. Upon receipt of such reimbursement, the Acquiring Party shall execute and deliver an appropriate assignment to such Offeree. If the Acquiring Party does not receive the amount due from the Offeree within five (5) days after the receipt by the Offeree of the invoice for its costs, the Acquiring Party may, at its election, give written notice to such delinquent party that the failure of the Acquiring Party to receive the amount due within forty-eight (48) hours after receipt of such notice by the delinquent Offeree shall constitute a withdrawal by the delinquent Offeree of its former election to acquire the interest, and such Offeree shall no longer have the right to acquire an interest in the offered Mineral Interest. Unless the delinquent party pays

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the amount due within said forty-eight (48) hour period provided for in said written notice, the delinquent party shall have no right to acquire an interest in the offered Mineral Interest.

D. Any assignment made by the Acquiring Party shall be made free and clear of any burdens placed thereon by the Acquiring Party but otherwise shall be made without warranty of title, either express or implied, even to the return of the purchase price. The assignment shall be made and accepted subject to, and each assignee shall expressly assume its portion of, all of the obligations of the Acquiring Party.

E. If the Mineral Interest covers lands both within and without the AMI, the Acquiring Party may, at its option, offer either the entire Mineral Interest, or only the portion of the Mineral Interest, covering lands within the AMI. If less than the entirety is offered, the Acquiring Party's costs applicable to the offered interest shall be that proportion of the total costs which the Mineral Interest offered bears to the total Mineral Interest. If the entirety of the premises covered by the Mineral Interest is offered and each party hereto acquires its proportionate interest, the lands lying outside the AMI shall become a part of the Contract Area subject hereto but the AMI shall not thereby be enlarged. If less than all of the parties acquire their proportionate interest in the Mineral Interest, the Mineral Interest so acquired shall not be subject to this Operating Agreement, but shall be subject to an operating agreement on a form identical to this Operating Agreement (without this Area of Mutual Interest provision) between the parties hereto who acquire an interest in such Mineral Interest. If less than all the parties acquired their proportionate interest in a Mineral Interest which is included in a drillsite, Exhibit "A" to this Operating Agreement shall be revised to reflect the proportionate ownership on an acreage basis within the drillsite.

N. Occasionally, the parties to a JOA anticipate conducting geoscience operations on the Contract Area. The following provision provides an order procedure for the proposing of geoscience operations:

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Geoscience Operations

Any party may propose that geoscience operations be conducted on the Contract Area lands. Geoscience operations shall be defined as seismic and other geophysical work and interpretation, purchase of seismic, geophysical, geochemical or geologic information, interpretations or data from third parties, surface geological or geochemical studies, gravity and magnetic surveys, and other exploratory work, investigations, and interpretations other than the actual drilling of an oil and gas well.

The party (hereinafter referred to as "proposing party") wishing to conduct geoscience operations shall furnish the other party(s) (hereinafter referred to as "non-proposing party(s)") with an informational notice which generally describes the proposed geoscience operation, specifying the location of the operation, recording parameters or a description of the operation and a list of the contractors which will be solicited to perform the operation.

After the proposing party has analyzed the solicited bids, the proposing party shall provide the non-proposing party(s) with a detailed, written geoscience proposal, specifying the contractor selected, the work to be performed and the estimated cost of the geoscience operation. Upon receipt of this geoscience proposal, the non-proposing party(s) shall have five (5) days (exclusive of Saturday, Sunday and legal holidays) to notify the proposing party in writing of its decision to participate in the geoscience operation. The failure of the non-proposing party to respond within said five (5) day period shall be deemed an election not to participate in the proposed geoscience operation. Thereafter, the proposing party shall be free to enter into a contract to conduct such geoscience operation.

If less than all parties approve any proposed geoscience operation, the proposing party shall advise those consenting parties who have elected to participate in the geoscience operation of the total interest of the consenting parties approving such geoscience operation and its recommendation as to whether the consenting parties should proceed with the geoscience operation as proposed. Each consenting

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party, within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of such notice shall advise the proposing party in writing of its desire to either limit its participation to such party's interest as shown on Exhibit "A" to the Operating Agreement or to carry its proportionate part of the non-consenting party(s) interest. The failure to respond to this notice shall be deemed an election to carry its proportionate share of a non-consenting party(s) interest. The proposing party may, at its election, withdraw such geoscience proposal if there is insufficient participation and shall promptly notify all parties of such decision.

If any of the non-proposing parties elect to participate in the geoscience operation, the proposing party must commence such geoscience operation within ninety (90) days from the date the detailed written geoscience proposal is presented to the non-proposing party(s). If the geoscience operation is not commenced within said ninety (90) day period, the rights of the proposing party to conduct such operation shall lapse and the operation must, if any party still desires to conduct such, be resubmitted to the other party(s), in accordance with this provision as if no prior geoscience proposal had been made.

The Operator shall supervise the geoscience program. In the event the Operator elects not to participate in such geoscience program, the proposing party shall supervise the geoscience program.

All information, data and materials generated as a result of the geoscience operation shall be owned by the party or parties who have participated in the geoscience operation in the proportion that they have paid for the geoscience operation. Copies of all information, data and materials generated shall be timely disseminated by the party supervising the geoscience operation to those parties who have elected to participate in the geoscience operation. A party who does not participate in a geoscience operation shall not receive or have access to information, data or materials generated by such operation. However, if the non-consenting party(s) thereafter desires to receive the data generated from such geoscience operation, the non-consenting party(s) may, by first paying to the consenting party(s), a sum equal to _____ () percent of such non-consenting

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party's proportionate interest in said prior geoscience operation. Thereupon, such party(s) shall then be entitled to receive information, data and materials obtained from the geoscience operation, which information, data and materials shall thereafter be owned as to the proportionate interest paid by such party.

Should a party who elected not to participate in any geoscience operation wish to participate in any subsequent geoscience operation, the development of which is based on and in the same general area as the prior geoscience operation, such party may do so by first paying to the party(s) who conducted the prior geoscience operation a sum equal to _____ () percent of such non-consenting party(s) interest in said prior geoscience operation. Thereafter, the information, data and materials shall be owned as to the respective interest paid by each consenting party.

All jointly owned geophysical, geological and other geoscience data acquired, compiled or generated pursuant to and after the effective date of this Agreement shall be treated as confidential for a period of _____ () years, and shall not be sold, traded or otherwise disposed of or divulged without the prior written consent of the parties participating in the acquisition of such data; provided that access to such data may be made available to a party's parent company and or its subsidiaries, agents, employees, contractors engaged in the performance of any work hereunder, third parties (but only to the extent such third parties are contacted pursuant to a farmout to such third party), or to any other person or entity where disclosure is required by law. Such jointly owned data shall not be available for brokerage until termination of the confidentiality obligations hereinabove specified, unless otherwise mutually agreed to by all parties owning the data. If any income or information is derived from sale or trade of any jointly owned information, data or materials acquired pursuant to the Agreement, that information or income shall be shared based on the proportionate interest of each party who participated in such geoscience operation.

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To avoid administrative problems with regard to sharing any remuneration received from the sale or trade of old geoscience data, the following additional paragraph could be added at the end of this provision:

Notwithstanding anything to the contrary, after the expiration of _____ () years following the effective date of this Agreement, all information, data and or materials acquired jointly pursuant to this Agreement shall be independently owned by each party who participated in any such geoscience operation and each participating party shall have the right to separately sell, trade or otherwise dispose of such data without the obligation to share any remuneration received with the other participating parties.

- O. In light of the recent increase in the incidents of bankruptcy, a bankruptcy provision dealing with the rejection or assumption of the JOA as an executory contract may be advisable. The inclusion of such a provision would force the debtor to either reject or accept the JOA in a timely manner. Moreover, if the debtor (or trustee) accepts the JOA, it must provide adequate financial assurances by either advancing payments or depositing amounts to be due in escrow.

Bankruptcy

If, following the granting of relief under the Bankruptcy Code to any party hereto as debtor thereunder, this Agreement should be held to be an executory contract under the Bankruptcy Code, then any remaining party shall be entitled to a determination by debtor or any trustee for debtor within thirty (30) days from the date an order for relief is entered under the Bankruptcy Code as to the rejection or assumption of this Agreement. In the event of an assumption, such party seeking determination shall be entitled to adequate assurances as to the future performance of debtor's obligation hereunder and the protection of the interest of all parties. The debtor shall satisfy its obligation to provide adequate assurances by either advancing payments or depositing the debtor's proportionate share of expenses in escrow.

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- P. As discussed previously, Article VII.B. grants to the parties a mutual lien on the oil and gas rights. This lien may be subordinate to the rights of other creditors of the defaulting party unless it is perfected. The common law equitable lien or mining partner's lien contained in the JOA is subordinate to the rights of creditors. A contractual lien must be filed of record to be given priority. Therefore, to be given priority, the JOA needs to be acknowledged and filed of record or a Memorandum of Operating Agreement needs to be filed of record.

Pursuant to the Bankruptcy Act, a bankruptcy trustee or a debtor-in-possession can avoid unrecorded instruments affecting real property if the instruments are ineffective under the applicable state law against bona fide purchasers for value. To avoid this result, the JOA or a Memorandum of Operating Agreement should be filed of record. The filing of the JOA or a Memorandum of Operating Agreement in the county records only perfects the real property lien, and the security interest in personal property and fixtures granted by the JOA should also be perfected. To perfect a security interest in personal property under the Uniform Commercial Code generally requires the filing of a financing statement in the county records (to perfect the security interest in hydrocarbons, accounts and fixtures) and the filing of the financing statement in the office of the Secretary of State (to perfect the security interest in all other personal property.) Filing requirements vary, and it is advisable to examine the individual state's procedure to ensure proper perfection.

The Memorandum of Operating Agreement and Financing Statement needs to be modified to comply with the idiosyncrasies of the state's statutory requirements. While most states have adopted the Uniform Commercial Code without revision of the applicable provisions, many states have adopted the Uniform Commercial Code and in addition, require witnesses, the name of the preparer of a document, the insertion of special language or a social security number or a tax identification number. Before using any form that is to be filed of record, it is necessary to examine the specific state law.

When dealing with a party who has or may have financial problems, it is always advisable to utilize an Advance of Well Cost provision or an Escrow Provision. When it is impossible to do so, a party may wish to record the JOA, a

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Memorandum of JOA, and/or a Financing Statement. The suggested instrument is designed to be executed by the Operator and all Non-Operators and gives the non-defaulting parties a lien and a security interest in the property of any defaulting party(s). To my knowledge, no instrument of this nature has been used and care should be exercised before deciding to use this suggested instrument or a variation.

If two or more of the parties to a JOA desire to use a Memorandum of Operating Agreement and Financing Statement, include the following reference in Article XV.:

MEMORANDUM OF OPERATING AGREEMENT AND FINANCING STATEMENT

Some or all of the parties hereto have executed a Memorandum of Operating Agreement and Financing Statement to secure the lien and security interest provided by Article VII.B. herein. The Memorandum of Operating Agreement and Financing Statement shall promptly be filed of record to perfect the lien and security interest when the Operating Agreement becomes effective. Operator shall have the primary responsibility for recording the Memorandum of Operating Agreement and Financing Statement; however, any Non-Operator may record the Memorandum of Operating Agreement and Financing Statement.

On a separate form, the parties should execute a Memorandum of Operating Agreement and Financing Statement.

MEMORANDUM OF OPERATING AGREEMENT
AND FINANCING STATEMENT

This Memorandum of Operating Agreement and Financing Statement shall be effective when the Operating Agreement becomes effective, that being _____
_____.

The parties hereto have entered into an Operating Agreement, providing for the development and production of crude oil, natural gas and associated substances from the lands and leases (hereinafter called the "Contract Area") described in Exhibit A attached hereto, and designating _____
_____ as Operator to conduct such operations.

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The Operating Agreement contains an Accounting Procedure, along with provisions giving the parties hereto mutual liens and security interests where one or more parties hereto become Debtors to one or more other parties hereto. This Memorandum of Operating Agreement and Financing Statement incorporates by reference all of the terms and conditions of the Operating Agreement, including but not limited to the lien and security interest provisions.

The purpose of this Memorandum of Operating Agreement and Financing Statement is to place third parties on notice of the Operating Agreement, and to secure and perfect the mutual liens and security interests of the parties hereto.

The Operating Agreement specifically provides that:

1. The Operator shall conduct and direct and have full control of all Operations on the Contract Area as permitted and required by, and within the limits of the Operating Agreement.
2. The liability of the parties shall be several, not joint or collective. Each party shall be responsible only for its obligations and shall be liable only for its proportionate share of the costs of developing and operating the Contract Area.
3. Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a security interest in its share of oil and or gas when extracted and its interest in all equipment, to secure payment of its share of expense, together with interest thereon at the rate provided in the Accounting Procedure. To the extent that Operator has a security interest under the Uniform Commercial Code of the state, Operator shall be entitled to exercise the rights and remedies of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the rights or security interest for the payment thereof.

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4. If any Non-Operator fails to pay its share of costs when due, Operator may require other Non-Operators to pay their proportionate part of the unpaid share, whereupon the other Non-Operators shall be subrogated to Operator's lien and security interest.
5. The Operator grants to Non-Operators a lien and security interest equivalent to that granted to Operator as described in Paragraph 3 above, to secure payment by Operator of its own share of costs when due.

The Operating Agreement contains other provisions which do not conflict but supplement the above described provisions, including non-consent provisions which provide that parties who elect not to participate in certain operations shall be deemed to have relinquished their interest until the consenting parties are able to recover their costs of such operations plus a specified amount. Should any person or firm desire additional information regarding the Operating Agreement or wish to inspect a copy of the Operating Agreement, said person or firm should contact the Operator.

For purposes of protecting said liens and security interest, the undersigned parties agree that this Memorandum of Operating Agreement and Financing Statement covers all right, title and interest of the Debtor(s) in:

Security Interests

1. (a) All personal property located upon or used in connection with the Contract Area.
- (b) All fixtures on the Contract Area.
- (c) All oil, gas and associated substances of value in, on or under the Contract Area which may be extracted therefrom.
- (d) All accounts resulting from the sale of the items described in subparagraph (c) at the wellhead of every well located on the Contract Area or on lands pooled therewith.

Article XV

(e) All items used, useful, or purchased for the production, treatment, storage, transportation, manufacture, or sale of the items described in subparagraph (c).

(f) All accounts, contract rights, rights under any gas balancing agreement, general intangibles, equipment, inventory, farmout rights, option farmout rights, acreage and or cash contributions, and conversion rights, whether now owned or existing or hereafter acquired or arising, including but not limited to all interest in any partnership, limited partnership, association, joint venture, or other entity or enterprise that holds, owns, or controls any interest in the Contract Area or in any property encumbered by this Memorandum of Operating Agreement and Financing Statement.

(g) All severed and extracted oil, gas, and associated substances now or hereafter produced from or attributable to the Contract Area, including without limitation oil, gas and associated substances in tanks or pipelines or otherwise held for treatment, transportation, manufacture, processing or sale.

(h) All the proceeds and products of the items described in the foregoing paragraphs now existing or hereafter arising, and all substitutions therefor, replacements thereof, or accessions thereto.

(i) All personal property and fixtures now and hereafter acquired in furtherance of the purposes of this Operating Agreement.

2. Certain of the above-described items are or are to become fixtures on the Contract Area.
3. The proceeds and products of collateral are also covered.

Article XV

Lien Property

- (a) All real property within the Contract Area, including all oil, gas and associated substances of value in, on or under the Contract Area which may be extracted therefrom.
- (b) All fixtures within the Contract Area.
- (c) All real property and fixtures now and hereafter acquired in furtherance of the purposes of this Operating Agreement.

The above items will be financed at the wellhead of the well or wells located on the Contract Area, and this Memorandum of Operating Agreement and Financing Statement is to be filed for record in the real estate records of the county or counties in which the Contract Area is located, and in the uniform commercial code records. All parties who have executed the subject Operating Agreement and all farmers and option farmers who have granted support within the Contract Area are identified on Exhibit A.

On default of any covenant or condition of the Operating Agreement, in addition to any other remedy afforded by law or the practice of this state, each party to the agreement and any successor to such party by assignment, operation of law, or otherwise, shall have, and is hereby given and vested with, the power and authority to take possession of and sell any interest which the defaulting party has in the subject lands and to foreclose this lien in the manner provided by law.

Upon expiration of the subject Operating Agreement and the satisfaction of all debts, the Operator shall file of record a Release of this Memorandum of Operating Agreement and Financing Statement on behalf of all parties concerned.

It is understood and agreed by the parties hereto that if any part, term, or provision of this Memorandum of Operating Agreement and Financing Statement is by the courts held to be illegal or in conflict with any law of the state where made, the validity of the remaining portions or provisions shall not be affected, and the rights and obligations

Article XV

of the parties shall be construed and enforced as if the Memorandum of Operating Agreement and Financing Statement did not contain the particular part, term or provision held to be invalid.

This Memorandum of Operating Agreement and Financing Statement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns. The failure of one or more persons owning an interest in the Contract Area to execute this Memorandum of Operating Agreement and Financing Statement shall not in any manner affect the validity of the Memorandum of Operating Agreement and Financing Statement as to those persons who have executed this Memorandum of Operating Agreement and Financing Statement.

A party having an interest in the Contract Area can ratify this Memorandum of Operating Agreement and Financing Statement by execution and delivery of an instrument of ratification, adopting and entering into this Memorandum of Operating Agreement and Financing Statement, and such ratification shall have the same effect as if the ratifying party had executed this Memorandum of Operating Agreement and Financing Statement or a counterpart thereof. By execution or ratification of this Memorandum of Operating Agreement and Financing Statement, such party hereby consents to its ratification and adoption by any party who may have or may acquire any interest in the Contract Area.

This Memorandum of Operating Agreement and Financing Statement may be executed or ratified in one or more counterparts and all of the executed or ratified counterparts shall together constitute one instrument. For purposes of recording, only one copy of this Memorandum of Operating Agreement and Financing Statement with individual signature pages attached thereto needs to be filed of record.

Article XV

COMPANY NAME
Address

By: _____
Its: _____

(Acknowledgment)

COMPANY NAME
Address

By: _____
Its: _____

(Acknowledgment)

COMPANY NAME
Address

By: _____
Its: _____

(Acknowledgment)

Article XV

A financing statement is valid for five years. To perpetuate a financing statement, the parties will have to file a continuation statement.

CONTINUATION STATEMENT

MEMORANDUM OF OPERATING AGREEMENT
AND FINANCING STATEMENT

Original File No. _____
Continuation File No.(s) _____ (If any)

Effective _____, the original Memorandum of Operating Agreement and Financing Statement shall continue to be effective as to the parties to this statement.

COMPANY NAME
Address

By: _____
Its: _____

COMPANY NAME
Address

By: _____
Its: _____

Article XV

COMPANY NAME
Address

By: _____
Its: _____

When the JOA expires, good practices dictate that a release should be filed. The following Release of Memorandum of Operating Agreement and Financing Statement should be examined to ensure that the instrument complies with the idiosyncrasies of state law. Note that the Memorandum of Operating Agreement and Financing Statement provides that "Upon expiration of the subject Operating Agreement, the Operator designated herein is empowered to sign a Release of this Memorandum of Operating Agreement and Financing Statement on behalf of all parties concerned."

RELEASE OF MEMORANDUM OF OPERATING AGREEMENT
AND FINANCING STATEMENT

The undersigned, _____

_____ hereby certifies that the Memorandum of Operating Agreement and Financing Statement dated _____ 19____, executed by _____, as Operator, and

as Non-Operator(s), and recorded _____, 19____, in the office of the _____ of the County of _____, State of _____, in Book _____, Page _____, empowers the Operator to sign a Release, upon expiration of the subject Operating Agreement, and by virtue of this authority, the undersigned hereby certifies that the subject Operating Agreement has expired and the Memorandum of Operating Agreement and Financing Statement has been fully released and discharged.

Article XV

In witness whereof, this Release of Memorandum of Operating Agreement and Financing Statement is executed as of the _____ day of _____, 19____.

Company Name
Address

By: _____

Its: _____

Date: _____

(Acknowledgment)

If one or more of the parties desire additional security, a provision which would perfect the security interest in pre-existing JOAs and in future JOAs could be added. The inclusion of such a "now and hereafter" could be worded as follows:

If the parties to this Operating Agreement also are or become parties in any other Operating Agreement presently in existence or entered into hereafter, then the lien and security interest described in this instrument also secures such parties' share of all expenses incurred under any other Operating Agreement and advanced, or to be advanced in the future, plus interest at the rate specified in such other Operating Agreement.

Alternatively, the parties could limit the scope of such an addition to cover only future JOAs.

If the parties to this Operating Agreement also enter into any other Operating Agreements, then the lien and security interest described in this instrument would also secure such parties' share of all expenses incurred under any such future Operating Agreements or advances made under any such Operating Agreement, plus interest at the rate specified in such Operating Agreement.

Article XV

Provisions that grant a lien or security interest in assets that are unrelated to a specific JOA may be viewed as overreaching and thus not accepted. As the use of instruments of this nature are somewhat novel, in most circumstances it is advisable not to include "now and hereafter" language. If the incorporation of these provisions is desired, the Contract Area will need to be described and the instrument will have to be filed of record in all counties where the property is located and in the proper state offices.

- Q. Additional provisions may be added, as required by a particular arrangement to reflect the parties' intentions. Such provisions should be drafted simply and clearly with the aid of an attorney.

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ARTICLE XVI.
MISCELLANEOUS

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

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

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

OPERATOR

NON-OPERATORS

EXHIBIT "A"
TO OPERATING AGREEMENT

On the following pages you will find a series of Exhibit "A" forms.

EXHIBIT A
TO OPERATING AGREEMENT

CONTRACT AREA AND PARTIES

CONTRACT AREA

DEPTH LIMITATIONS

PARTIES AND INTERESTS

Name and Address

Percentage Interest

(SAMPLE)
EXHIBIT "A"

Attached to and made a part of _____

I. CONTRACT AREA LANDS

II. ADDRESSES FOR NOTICE PURPOSES

III. PERCENTAGE WORKING INTERESTS OF THE PARTIES

<u>Parties</u>	<u>Net Surface Acres Committed</u>	<u>Percentage Working Interest in Contract Area</u>	%
Totals	_____	100.00000%	

IV. DESCRIPTION OF COMMITTED LEASEHOLD AND OIL AND GAS INTERESTS

Each of the Oil, Gas and Mineral Leases, Oil and Gas Leases, Oil and Gas Interests, or undivided interests therein, committed to this Agreement by the parties hereto and listed hereinafter are committed INSOFAR, AND ONLY INSOFAR, as each covers lands and depths within the Contract Area. All recording references are to the _____ Records of the _____, _____ County _____.

A. Leases committed by _____ (100%):

<u>LESSOR</u>	<u>LESSEE</u>	<u>LEASE DATE</u>	<u>LEASE EXPIRATION</u>	<u>NET SURFACE ACRES COMMITTED</u>	<u>LESSOR ROYALTY</u>	<u>OTHER BURDENS</u>	<u>RECORDING REFERENCES BOOK PAGE</u>
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B. Leases committed by _____ (100%):

<u>LESSOR</u>	<u>LESSEE</u>	<u>LEASE DATE</u>	<u>LEASE EXPIRATION</u>	<u>NET SURFACE ACRES COMMITTED</u>	<u>LESSOR ROYALTY</u>	<u>OTHER BURDENS</u>	<u>RECORDING REFERENCES BOOK PAGE</u>
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C. Leases committed by _____ (%), _____ (%), and _____ (%) in the respective proportions indicated:

<u>LESSOR</u>	<u>LESSEE</u>	<u>LEASE DATE</u>	<u>LEASE EXPIRATION</u>	<u>NET SURFACE ACRES COMMITTED</u>	<u>LESSOR ROYALTY</u>	<u>OTHER BURDENS</u>	<u>RECORDING REFERENCES BOOK PAGE</u>
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D. _____ (100%) commits an _____ unleased, undivided (Insert Fraction) mineral interests in (description of acreage), being _____ total net mineral acres unleased.

<u>GRANTOR</u>	<u>GRANTEE</u>	<u>DEED DATE</u>	<u>BURDENS ON PRODUCTION</u>	<u>RECORDING REFERENCE BOOK PAGE</u>
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(SAMPLE)
EXHIBIT "A"

Attached to and made a part of _____

A. Lands Subject to this Agreement

_____ acres, more or less, being all of Sections _____ and _____, T _____ S - R _____ E, _____ County, _____, and Section _____ and _____, T _____ S - R _____ E, _____ County, _____, covering depths from the surface down to the stratigraphic equivalent of the deepest depth penetrated in any well drilled hereunder prior to the first completion of a well hereunder producing, or capable of producing, oil and/or gas in paying quantities; provided, however, in no event shall the deepest depth of the Contract Area extend below the base of the _____ formation.

B. Committed Leasehold Interests

Each of the Oil, Gas and Mineral Leases, Oil and Gas Leases, Oil and Gas Interests, or undivided interests therein, committed to this Agreement by the parties hereto and listed hereinafter are committed INsofar, AND ONLY INsofar, as each covers lands and depths within the Contract Area. All recording references are to the _____ Records of the _____, _____ County _____.

All recording references are to the _____ Records of the _____, _____ County, _____.

1. Leases committed by _____ (100%) under farmout from _____ dated _____:

<u>LESSOR</u>	<u>LESSEE</u>	<u>LEASE DATE</u>	<u>LEASE EXPIRATION</u>	<u>NET SURFACE ACRES COMMITTED</u>	<u>LESSOR ROYALTY</u>	<u>OTHER BURDENS</u>	<u>RECORDING REFERENCES BOOK PAGE</u>
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2. Leases committed by _____ (100%):

<u>LESSOR</u>	<u>LESSEE</u>	<u>LEASE DATE</u>	<u>LEASE EXPIRATION</u>	<u>NET SURFACE ACRES COMMITTED</u>	<u>LESSOR ROYALTY</u>	<u>OTHER BURDENS</u>	<u>RECORDING REFERENCES BOOK PAGE</u>
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3. Leases committed by _____ (%), _____ (%), _____ (%) in the respective proportions indicated:

<u>LESSOR</u>	<u>LESSEE</u>	<u>LEASE DATE</u>	<u>LEASE EXPIRATION</u>	<u>NET SURFACE ACRES COMMITTED</u>	<u>LESSOR ROYALTY</u>	<u>OTHER BURDENS</u>	<u>RECORDING REFERENCES BOOK PAGE</u>
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C. Percentage Working Interests of the Parties

<u>Parties</u>	<u>Net Acres Committed</u>	<u>Contract Area Prior to Farmouts</u>	<u>Initial (or Substitute) Well and its Proration Unit Prior to Payout</u>	<u>Proration Unit for Initial Well (or its Substitute) after Payout* and the Remainder of the Contract Area</u>
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* Computed on the basis that each Farmout Party converts its respective retained ORRI to a working interest at payout.

D. Addresses of the Parties

EXHIBIT "B"
TO OPERATING AGREEMENT

FORM OF LEASE

EXHIBIT "B"
TO OPERATING AGREEMENT

6972-B
PROD 88 (REV 10/83)
PRINTED IN USA

PAID UP OIL AND GAS LEASE

THIS LEASE AGREEMENT is made as of the _____ day of _____, 19____, between _____

_____ as Lessor (whether one or more),
and _____

as Lessee. All printed portions of this lease were prepared by the party hereinabove named as Lessee, but all other provisions (including the completion of blank spaces) were prepared jointly by Lessor and Lessee.

1. **Description.** In consideration of a cash bonus in hand paid and the covenants herein contained, Lessor hereby grants, leases and lets exclusively to Lessee the following described land, hereinafter called leased premises: (use Exhibit "A" for long description):

in the county of _____, State of _____, containing _____ gross acres, more or less (including any interests therein which Lessor may hereafter acquire by reversion, prescription or otherwise), for the purpose of exploring for, developing, producing and marketing oil and gas, along with all hydrocarbon and nonhydrocarbon substances produced in association therewith. The term "gas" as used herein includes helium, carbon dioxide and other commercial gases, as well as hydrocarbon gases. In addition to the above-described leased premises, this lease also covers accretions and any small strips or parcels of land now or hereafter owned by Lessor which are contiguous or adjacent to the above-described leased premises, and, in consideration of the aforementioned cash bonus, Lessor agrees to execute at Lessee's request any additional or supplemental instruments for a more complete or accurate description of the land so covered. For the purpose of determining the amount of any shut-in royalties hereunder, the number of gross acres above specified shall be deemed correct, whether actually more or less.

2. **Term of Lease.** This lease, which is a "paid-up" lease requiring no rentals, shall be in force for a primary term of _____ years from the date hereof, and for as long thereafter as oil or gas or other substances covered hereby are produced in paying quantities from the leased premises or from lands pooled therewith or this lease is otherwise maintained in effect pursuant to the provisions hereof.

3. **Royalty Payment.** Royalties on oil, gas and other substances produced and saved hereunder shall be paid by Lessee to Lessor as follows: (a) For oil and other liquid hydrocarbons separated at Lessee's separator facilities, the royalty shall be one-eighth of such production, to be delivered at Lessee's option to Lessor at the wellhead or to Lessor's credit at the oil purchaser's transportation facilities, provided that Lessee shall have the continuing right to purchase such production at the wellhead market price then prevailing in the same field (or if there is no such price then prevailing in the same field, then in the nearest field in which there is such a prevailing price) for production of similar grade and gravity; (b) for gas (including casinghead gas) and all other substances covered hereby, the royalty shall be one-eighth of the proceeds realized by Lessee from the sale thereof, less a proportionate part of ad valorem taxes and production, severance, or other excise taxes and the costs incurred by Lessee in delivering, processing or otherwise making such gas or other substances merchantable, provided that Lessee shall have the continuing right to purchase such production at the prevailing wellhead market price paid for production of similar quality in the same field (or if there is no such price then prevailing in the same field, then in the nearest field in which there is such a prevailing price) pursuant to comparable purchase contracts entered into on the same or nearest preceding date as the date on which Lessee commences its purchases hereunder; and (c) if a well on the leased premises or lands pooled therewith is capable of producing oil or gas or any other substance covered hereby but such well is either shut-in or production therefrom is not being sold or purchased by Lessee or royalties on production therefrom are not otherwise being paid to Lessor, and if this lease is not otherwise maintained in effect, such well shall nevertheless be considered as though it were producing in paying quantities for the purpose of maintaining this lease whether during or after the primary term, and Lessee shall pay a shut-in royalty of One Dollar per acre then covered by this lease, such payment to be made to Lessor or to Lessor's credit in the depository designated below, on or before 90 days after the next ensuing anniversary date of this lease, and thereafter on or before each anniversary date hereof while the well is shut-in or production therefrom is not being sold or purchased by Lessee or royalties on production therefrom are not otherwise being paid to Lessor. This Lease shall remain in force so long as such well is capable of producing in paying quantities, and Lessee's failure to properly pay shut-in royalty shall render Lessee liable for the amount due but shall not operate to terminate this lease.

4. **Depository Agent.** All shut-in royalty payments under this lease shall be paid or tendered to Lessor or to Lessor's credit in _____

at _____
or its successors, which shall be Lessor's depository agent for receiving payments regardless of changes in the ownership of said land. All payments or tenders may be made in currency, or by check or by draft and such payments or tenders to Lessor or to the depository by deposit in the U.S. Mails in a stamped envelope addressed to the depository or to the Lessor at the last address known to Lessee shall constitute proper payment. If the depository should liquidate or be succeeded by another institution, or for any reason fail or refuse to accept payment hereunder, Lessor shall, at Lessee's request, deliver to Lessee a proper recordable instrument naming another institution as depository agent to receive payments.

5. **Operations.** If Lessee drills a well which is incapable of producing in paying quantities (hereinafter called "dry hole") on the leased premises or lands pooled therewith, or if all production (whether or not in paying quantities) permanently ceases from any cause, including a revision of unit boundaries pursuant to the provisions of Paragraph 6 or the action of any governmental authority, then in the event this lease is not otherwise being maintained in force it shall nevertheless remain in force if Lessee commences operations for reworking an existing well or for drilling an additional well or for otherwise obtaining or restoring production on the leased premises or lands pooled therewith within 90 days after completion of operations on such dry hole or within 90 days after such cessation of all production. If at the end of the primary term, or at any time thereafter, oil, gas or other substances covered hereby are not being produced in paying quantities from the leased premises or lands pooled therewith, but Lessee is then engaged in drilling, reworking or any other operations reasonably calculated to obtain or restore production therefrom, this lease shall remain in force so long as any one or more of such operations are prosecuted with no cessation of more than 90 consecutive days, and if any such operations result in the production of oil or gas or other substances covered hereby, as long thereafter as there is production in paying quantities from the leased premises or lands pooled therewith. After completion of a well capable of producing in paying quantities hereunder, Lessee shall drill such additional wells on the leased premises or lands pooled therewith as a reasonably prudent operator would drill under the same or similar circumstances to (a) develop the leased premises as to formations then capable of producing in paying quantities on the leased premises or lands pooled therewith, or (b) protect the leased premises from uncompensated drainage by any well or wells located on other lands not pooled therewith. There shall be no covenant to drill exploratory wells or any additional wells except as expressly provided herein.

6. **Pooling.** Lessee shall have the right but not the obligation to pool all or any part of the leased premises or interest therein with any other lands or interests, as to any or all depths or zones, and as to any or all substances covered by this lease, either before or after the commencement of production, whenever Lessee deems it necessary or proper to do so in order to prudently develop or operate the leased premises, whether or not similar pooling authority exists with respect to such other lands or interests. The unit formed by such pooling for an oil well shall not exceed 40 acres plus a maximum acreage tolerance of 10%, and for a gas well shall not exceed 640 acres plus a maximum acreage tolerance of 10%, except that larger units may be formed for oil wells or gas wells to conform to any well spacing or density pattern that may be prescribed or permitted by any governmental authority having jurisdiction. In exercising its pooling rights hereunder, Lessee shall file of record a written declaration describing the unit and stating the effective date of pooling. Production, drilling or reworking operations anywhere on a unit which includes all or any part of the leased premises shall be treated as if it were production, drilling or reworking operations on the leased premises, except that the production on which Lessor's royalty is calculated shall be that proportion of the total unit production produced and saved which the net acreage covered by this lease and included in the unit bears to the total gross acreage in the unit. Pooling in one or more instances shall not exhaust Lessee's pooling rights hereunder, and Lessee shall have the recurring right but not the obligation to revise any unit formed hereunder by expansion or contraction or both, either before or after commencement of production, in order to conform to the well spacing or density pattern prescribed or permitted by the governmental authority having jurisdiction, or to conform to any productive acreage determination made by such governmental authority. In making such a revision, Lessee shall file of record a written declaration describing the revised unit and stating the effective date of revision. To the extent any portion of the leased premises is included in or excluded from the unit by virtue of such revision, the proportion of unit production on which royalties are payable hereunder shall thereafter be adjusted accordingly. In the absence of production in paying quantities from a unit, or upon permanent cessation thereof, Lessee may terminate the unit by filing of record a written declaration describing the unit and stating the date of termination.

7. **Lesser Interest.** If Lessor owns less than the full mineral estate in all or any part of the leased premises, the royalties and shut-in royalties payable hereunder for any well on any part of the leased premises or lands pooled therewith shall be reduced to the proportion that Lessor's interest in such part of the leased premises bears to the full mineral estate in such part of the leased premises.

8. **Ownership Changes.** The interest of either Lessor or Lessee hereunder may be assigned, devised or otherwise transferred in whole or in part, by area and/or by depth or zone, and the rights and obligations of the parties hereunder shall extend to their respective heirs, devisees, executors, administrators, successors and assigns. No change in Lessor's ownership shall have the effect of reducing the rights or enlarging the obligations of Lessee hereunder, and no change in ownership shall be binding on Lessee until 60 days after Lessee has been furnished the original or certified or duly authenticated copies of the documents establishing such change of ownership to the satisfaction of Lessee or until Lessor has satisfied the notification requirements

contained in Lessee's usual form of division order. In the event of the death of any person entitled to shut-in royalties hereunder, Lessee may pay or tender such shut-in royalties to the credit of decedent or decedent's estate in the depository designated above. If at any time two or more persons are entitled to shut-in royalties hereunder, Lessee may pay or tender such shut-in royalties to such persons or to their credit in the depository, either jointly or separately in proportion to the interest which each owns. If Lessee transfers its interest hereunder in whole or in part Lessee shall be relieved of all obligations thereafter arising with respect to the transferred interest, and failure of the transferee to satisfy such obligations with respect to the transferred interest shall not affect the rights of Lessee with respect to any interest not so transferred. If Lessee transfers a full or undivided interest in all or any portion of the area covered by this lease, the obligation to pay or tender shut-in royalties hereunder shall be divided between Lessee and the transferee in proportion to the net acreage interest in this lease then held by each.

9. **Release of Lease.** Lessee may, at any time and from time to time, deliver to Lessor or file of record a written release of this lease as to a full or undivided interest in all or any portion of the area covered by this lease or any depths or zones thereunder, and shall thereupon be relieved of all obligations thereafter arising with respect to the interest so released. If Lessee releases all or an undivided interest in less than all of the area covered hereby, Lessee's obligation to pay or tender shut-in royalties shall be proportionately reduced in accordance with the net acreage interest retained hereunder.

10. **Ancillary Rights.** In exploring for, developing, producing and marketing oil, gas and other substances covered hereby on the leased premises or lands pooled or unitized therewith, in primary and/or enhanced recovery, Lessee shall have the right of ingress and egress along with the right to conduct such operations on the leased premises as may be reasonably necessary for such purposes, including but not limited to geophysical operations, the drilling of wells, and the construction and use of roads, canals, pipelines, tanks, water wells, disposal wells, injection wells, pits, electric and telephone lines, power stations, and other facilities deemed necessary by Lessee to discover, produce, store, treat and/or transport production. Lessee may use in such operations, free of cost, any oil, gas, water and/or other substances produced on the leased premises, except water from Lessor's wells or ponds. The right of ingress and egress granted hereby shall apply to the entire leased premises described in Paragraph 1 above, notwithstanding any partial release or other termination of this lease with respect thereto. When requested by Lessor in writing, Lessee shall bury its pipelines below ordinary plow depth on cultivated lands. No well shall be located less than 200 feet from any house or barn now on the leased premises without Lessor's consent, and Lessee shall pay for damage caused by its operations to buildings and other improvements now on the leased premises, and to commercial timber and growing crops thereon. Lessee shall have the right at any time to remove its fixtures, equipment and materials, including well casing, from the leased premises during the term of this lease or within a reasonable time thereafter.

11. **Regulation and Delay.** Lessee's obligations under this lease, whether express or implied, shall be subject to all applicable laws, rules, regulations and orders of any governmental authority having jurisdiction including restrictions on the drilling and production of wells, and the price of oil, gas and other substances covered hereby. When drilling, reworking, production or other operations are prevented or delayed by such laws, rules, regulations or orders, or by inability to obtain necessary permits, equipment, services, material, water, electricity, fuel, access or easements, or by fire, flood, adverse weather conditions, war, sabotage, rebellion, insurrection, riot, strike or labor disputes, or by inability to obtain a satisfactory market for production or failure of purchasers or carriers to take or transport such production, or by any other cause not reasonably within Lessee's control, this lease shall not terminate because of such prevention or delay, and at Lessee's option, the period of such prevention or delay shall be added to the term hereof. Lessee shall not be liable for breach of any express or implied covenants of this lease when drilling, production or other operations are so prevented, delayed or interrupted.

12. **Breach or Default.** No litigation shall be initiated by Lessor with respect to any breach or default by Lessee hereunder, for a period of at least 90 days after Lessor has given Lessee written notice fully describing the breach or default, and then only if Lessee fails to remedy the breach or default within such period. In the event the matter is litigated and there is a final judicial determination that a breach or default has occurred, this lease shall not be forfeited or cancelled in whole or in part unless Lessee is given a reasonable time after said judicial determination to remedy the breach or default and Lessee fails to do so.

13. **Warranty of Title.** Lessor hereby warrants and agrees to defend title conveyed to Lessee hereunder, and agrees that Lessee at Lessee's option may pay and discharge any taxes, mortgages or liens existing, levied or assessed on or against the leased premises. If Lessee exercises such option, Lessee shall be subrogated to the rights of the party to whom payment is made, and, in addition to its other rights, may reimburse itself out of any royalties or shut-in royalties otherwise payable to Lessor hereunder. In the event Lessee is made aware of any claim inconsistent with Lessor's title, Lessee may suspend the payment of royalties and shut-in royalties hereunder, without interest, until Lessee has been furnished satisfactory evidence that such claim has been resolved.

IN WITNESS WHEREOF, this lease is executed to be effective as of the date first written above, but upon execution shall be binding on the signatory and the signatory's heirs, devisees, executors, administrators, successors and assigns, whether or not this lease has been executed by all parties hereinabove named as Lessor.

WITNESSES AND/OR ATTESTATIONS:	LESSOR (WHETHER ONE OR MORE)	SS NO. OR TAX ID
_____	_____	_____
_____	_____	_____
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_____	_____	_____

ACKNOWLEDGEMENTS

STATE OF _____ }
 County of _____ } S.S. **INDIVIDUAL**
(For use in all states)
 On this _____ day of _____, 19_____, before me, the undersigned Notary Public in and for said county and state, personally appeared _____
 known to me to be the person or persons whose names are subscribed to the foregoing instrument, and acknowledged that the same was executed and delivered as their free and voluntary act for the purposes therein set forth. In witness whereof I hereunto set my hand and official seal as of the date hereinabove stated.
 My Commission Expires _____ Notary Public

STATE OF _____ }
 County of _____ } S.S. **INDIVIDUAL**
(For use in all states)
 On this _____ day of _____, 19_____, before me, the undersigned Notary Public in and for said county and state, personally appeared _____
 known to me to be the person or persons whose names are subscribed to the foregoing instrument, and acknowledged that the same was executed and delivered as their free and voluntary act for the purposes therein set forth. In witness whereof I hereunto set my hand and official seal as of the date hereinabove stated.
 My Commission Expires _____ Notary Public

RECORDING INFORMATION

STATE OF _____ }
 County of _____ } S.S.
 This instrument was filed for record on the _____ day of _____, 19_____, at _____ o'clock ____ M., and duly recorded in Book _____ Page _____, of the _____ records of this office.
 By _____ Clerk (or Deputy)

EXHIBIT "C"
TO OPERATING AGREEMENT

ACCOUNT PROCEDURE

JOINT OPERATIONS

EXHIBIT " C "

Attached to and made a part of Operating Agreement

**ACCOUNTING PROCEDURE
JOINT OPERATIONS**

I. GENERAL PROVISIONS

1. Definitions

"Joint Property" shall mean the real and personal property subject to the agreement to which this Accounting Procedure is attached.
"Joint Operations" shall mean all operations necessary or proper for the development, operation, protection and maintenance of the Joint Property.
"Joint Account" shall mean the account showing the charges paid and credits received in the conduct of the Joint Operations and which are to be shared by the Parties.
"Operator" shall mean the party designated to conduct the Joint Operations.
"Non-Operators" shall mean the Parties to this agreement other than the Operator.
"Parties" shall mean Operator and Non-Operators.
"First Level Supervisors" shall mean those employees whose primary function in Joint Operations is the direct supervision of other employees and/or contract labor directly employed on the Joint Property in a field operating capacity.
"Technical Employees" shall mean those employees having special and specific engineering, geological or other professional skills, and whose primary function in Joint Operations is the handling of specific operating conditions and problems for the benefit of the Joint Property.
"Personal Expenses" shall mean travel and other reasonable reimbursable expenses of Operator's employees.
"Controllable Material" shall mean Material which at the time is so classified in the Material Classification Manual as most recently recommended by the Council of Petroleum Accountants Societies.

2. Statement and Billings

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

3. Advances and Payments by Non-Operators

- A. Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation within fifteen (15) days after receipt of the billing or by the first day of the month for which the advance is required, whichever is later. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.
- B. Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the prime rate in effect at _____ on the first day of the month in which delinquency occurs plus 1% or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts.

4. Adjustments

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

The Council of Petroleum Accountants Societies published in 1984 an updated COPAS. The COPAS is attached to the JOA and establishes an accounting procedure to be used in exploring, developing and operating within the Contract Area.

Section I.3.

Section I.3.A. has been revised so that it is now consistent with Article VII.C. of the JOA. Pursuant to this provision, the Operator may require that Non-Operator's advance their estimated cash outlays for the succeeding month's operation within 5 days after receipt of the billing or by the first day of the month for which the advance is required, whichever is later. Curiously, Article VII.C of the JOA, unlike Section I.3.A., requires that the billing be submitted on or before the 20th day of the next preceding month.

Section I.3.B. has been amended to require the insertion of the name of a bank. Rather than use a fixed interest rate as did the 1974 COPAS, the 1984 COPAS imposes an interest rate which is 1% above the prime rate, unless the state's usury laws impose a lower rate. The variable nature of the rate should provide the requisite incentive for Non-Operators to timely pay their proportionate share of expenses in times of high interest rate. In appropriate circumstances, the prime rate plus 1% should be increased to prime plus 2% or 3% or 5%. Unless the interest rate is sufficiently high, it may be difficult for the Operator to enforce the timely payment of bills. Non-Operators have and can opt to pay the specified interest penalty rather than timely pay their proportionate share of expenses.

5. Audits

- A. A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct a joint audit in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator. The audits shall not be conducted more than once each year without prior approval of Operator, except upon the resignation or removal of the Operator, and shall be made at the expense of those Non-Operators approving such audit.
- B. The Operator shall reply in writing to an audit report within 180 days after receipt of such report.

6. Approval by Non-Operators

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

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. Ecological and Environmental

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

2. Rentals and Royalties

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

3. Labor

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

4. Employee Benefits

Operator's current costs of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II shall be Operator's actual cost not to exceed the percent most recently recommended by the Council of Petroleum Accountants Societies.

5. Material

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

6. Transportation

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

- A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store where like material is normally available or railway receiving point nearest the Joint Property unless agreed to by the Parties.

Section I.5.

The revised language eliminates a Non-Operator's right to an individual audit, if the Non-Operators, for whatever reason, could not schedule a joint audit. The revised language clarifies that the cost of joint audits will be borne by the Non-Operators who approve an audit and that audits will not be conducted more than once a year and with the approval of the Operator, except upon resignation or removal of the Operator.

Section I.5.B. was added to encourage Operators to respond to audit reports in a timely fashion.

Section I.6.

Where approval of the parties is mandated, any agreement or approval of a majority in interest of the Non-Operators shall be controlling on all Non-Operators.

Section II.1.

This provision was adapted from the 1976 Offshore COPAS. It provides that all ecological and environmental costs are to be charged to the Joint Account.

Section II.3.A.

This provision defines what labor expenses are to be charged to the Joint Account, if so elected by the parties pursuant to Section III.1.

- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store where like material is normally available, or railway receiving point nearest the Joint Property unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.
- C. In the application of subparagraphs A and B above, the option to equalize or charge actual trucking cost is available when the actual charge is \$400 or less excluding accessorial charges. The \$400 will be adjusted to the amount most recently recommended by the Council of Petroleum Accountants Societies.

7. Services

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 10 of Section II and Paragraph i, ii, and iii, of Section III. The cost of professional consultant services and contract services of technical personnel directly engaged on the Joint Property if such charges are excluded from the overhead rates. The cost of professional consultant services or contract services of technical personnel not directly engaged on the Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.

8. Equipment and Facilities Furnished By Operator

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

9. Damages and Losses to Joint Property

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

10. Legal Expense

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

11. Taxes

All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof, or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties. If the ad valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then notwithstanding anything to the contrary herein, charges to the Joint Account shall be made and paid by the Parties hereto in accordance with the tax value generated by each party's working interest.

12. Insurance

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

13. Abandonment and Reclamation

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

14. Communications

Cost of acquiring, leasing, installing, operating, repairing and maintaining communication systems, including radio and microwave facilities directly serving the Joint Property. In the event communication facilities/systems serving the Joint Property are Operator owned, charges to the Joint Account shall be made as provided in Paragraph 8 of this Section II.

15. Other Expenditures

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

Section II.6.C.

The 1984 COPAS adopted a frequent industry revision and increased the \$200 freight-equalization charge to \$400.

Section II.8.

The 1984 COPAS replaced a fixed limit on depreciation (previously 8%) with a blank which is to be completed at the time the COPAS is prepared. Since publication of the 1984 COPAS, industry has generally applied a depreciation limitation of between 12% and 15%.

In summary, if the Operator utilizes his equipment or facilities for the benefit of the Non-Operators within the Contract Area, the Operator can charge to the Joint Account an amount "commensurate with cost of ownership and operation" or "the average commercial rates prevailing in the immediate area of the Joint Property less 20%."

Section II.9.

See the discussion associated with Article V.A and Article VIII.D.3. of the JOA.

Section II.10.

See the discussion associated with Article X. of the JOA.

Section II.11.

See Article VII.F of the JOA. The 1984 COPAS has been revised to provide explicitly for the disproportionate assessment of ad valorem taxes. Ad valorem taxes are to be borne in the ratio of the value "generated by each party's working interest."

Section II.12.

Insurance premiums are to be charged to the Joint Account. Although insurance expense is often ignored, Operators can, where they are permitted to self-insure for Worker's Compensation or Employer's Liability, charge to the Joint Account an insurance expense which is "not to exceed manual rates."

- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store where like material is normally available, or railway receiving point nearest the Joint Property unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.
- C. In the application of subparagraphs A and B above, the option to equalize or charge actual trucking cost is available when the actual charge is \$400 or less excluding accessorial charges. The \$400 will be adjusted to the amount most recently recommended by the Council of Petroleum Accountants Societies.

7. Services

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 10 of Section II and Paragraph i, ii, and iii, of Section III. The cost of professional consultant services and contract services of technical personnel directly engaged on the Joint Property if such charges are excluded from the overhead rates. The cost of professional consultant services or contract services of technical personnel not directly engaged on the Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.

8. Equipment and Facilities Furnished By Operator

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

9. Damages and Losses to Joint Property

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

10. Legal Expense

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

11. Taxes

All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof, or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties. If the ad valorem taxes are based in whole or in part upon separate valuations of each party's working interest, then notwithstanding anything to the contrary herein, charges to the Joint Account shall be made and paid by the Parties hereto in accordance with the tax value generated by each party's working interest.

12. Insurance

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

13. Abandonment and Reclamation

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

14. Communications

Cost of acquiring, leasing, installing, operating, repairing and maintaining communication systems, including radio and microwave facilities directly serving the Joint Property. In the event communication facilities/systems serving the Joint Property are Operator owned, charges to the Joint Account shall be made as provided in Paragraph 8 of this Section II.

15. Other Expenditures

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

Section II.13.

The drafters of the 1984 COPAS recognized that abandonment and reclamation expenses are of substantial magnitude and should be explicitly acknowledged to be charged to the Joint Account.

Section II.14.

As a consequence of the movement to conduct operations in remote areas, this provision, which was adapted from the 1976 Offshore COPAS, has been incorporated. Paragraph 14 recognizes the necessity of using in remote areas sophisticated technology which is housed in a central location. Expenses associated with the use and transmission of this information is to be charged to the Joint Account.

III. OVERHEAD

1. Overhead – Drilling and Producing Operations

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

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

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 3A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

- ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property:

- () shall be covered by the overhead rates, or
() shall not be covered by the overhead rates.

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

- () shall be covered by the overhead rates, or
() shall not be covered by the overhead rates.

A. Overhead – Fixed Rate Basis

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

Drilling Well Rate \$ _____
(Prorated for less than a full month)

Producing Well Rate \$ _____

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

(a) Drilling Well Rate

- (1) Charges for drilling wells shall begin on the date the well is spudded and terminate on the date the drilling rig, completion rig, or other units used in completion of the well is released, whichever is later, except that no charge shall be made during suspension of drilling or completion operations for fifteen (15) or more consecutive calendar days.
- (2) Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive work days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig or other units used in workover, commence through date of rig or other unit release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive calendar days.

(b) Producing Well Rates

- (1) An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.
- (2) Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.
- (3) An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.
- (4) A one-well charge shall be made for the month in which plugging and abandonment operations are completed on any well. This one-well charge shall be made whether or not the well has produced except when drilling well rate applies.
- (5) All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.
- (3) The well rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

B. Overhead - Percentage Basis

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

Section III.1.

This provision allows the parties to decide on a case-by-case basis whether:

- i. a fixed overhead rate or a rate based on the percentage of the cost of development and operations should be applied,
- ii. the expenses of technical personnel directly employed on the Joint Property should be charged to the Joint Account or carried as an overhead expense,
- iii. the expenses of technical personnel temporarily or permanently assigned to and directly employed in the operation of the Joint Property should be charged to the Joint Account. This provision was added to give the parties the discretion to have expenses related to "offsite" technical employees charged to the Joint Account. The 1974 COPAS was frequently modified to provide that "offsite" technical support was to be charged to the Joint Account where the COPAS governed the operations conducted in remote areas, Alaska and the West Coast.

Generally, the Fixed Rate Basis is selected. It is obviously in the Operator's interest to charge "onsite" and "offsite" technical personnel expenses to the Joint Account; however, this decision is often subject to heated negotiations. If "onsite" and/or "offsite" technical personnel expenses are to be included in overhead, the Operator should propose overhead rates which reflect this increased cost.

Section III.1.A.

The Drilling Well Rate and the Producing Well Rate will differ depending upon the location of the well. The 1984 COPAS adopted an industry custom and now provides that Drilling Well Rates should be prorated when drilling does not occur for a full month. Drilling Well Rates and Producing Well Rates are defined in Section III.A.(2) and this provision should be carefully studied.

Section III.A.(3)

The Drilling Well Rate and the Producing Well Rate shall be adjusted annually in April, in accordance with the increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers. This provision has frequently been ignored, to the detriment of the Operator.

(a) Development
_____ Percent (_____%) of the cost of development of the Joint Property exclusive of costs provided under Paragraph 10 of Section II and all salvage credits.

(b) Operating
_____ Percent (_____%) of the cost of operating the Joint Property exclusive of costs provided under Paragraphs 2 and 10 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.

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

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

2. Overhead - Major Construction

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

- A. _____ % of first \$100,000 or total cost if less, plus
- B. _____ % of costs in excess of \$100,000 but less than \$1,000,000, plus
- C. _____ % of costs in excess of \$1,000,000.

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

3. Catastrophe Overhead

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

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

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

4. Amendment of Rates

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

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

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

1. Purchases

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

2. Transfers and Dispositions

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

Section III.1.B.

Paragraphs (a) and (b) need to be completed if Percentage Basis in Section III.1.i. was selected.

Section III.2.

Although frequently not completed, it is advisable to negotiate and complete this provision at the time the COPAS is prepared. Parties frequently provide that this provision is "to be negotiated." When it is completed, the parties generally agree that the Operator shall charge the Joint Account for any Major Construction Project in excess of \$25,000 at the rate of 5% of the first \$100,000, 3% of costs in excess of \$100,000 but less than \$1,000,000 and 2% of costs in excess of \$1,000,000. The 1984 COPAS has specifically eliminated any additional overhead charge for the installation of artificial lift equipment. If, due to the nature of the equipment to be installed or the location, this restriction is unacceptable, it can be deleted.

Section III.3.

This provision was added to the 1984 COPAS. It was derived from the 1976 Offshore COPAS. As with Section III.2., it is advisable to negotiate and complete this provision at the time the COPAS is prepared. The same percentages used in Section III.2. can be inserted in this provision. Depending on the extent and nature of the damage, the percentage may be high or low. This will turn on whether the restoration of the property requires additional engineering to replace the damaged or lost facilities.

A. New Material (Condition A)

(1) Tubular Goods Other than Line Pipe

- (a) Tubular goods, sized 2? inches OD and larger except line pipe, shall be priced at Eastern mill published carload base prices effective as of date of movement plus transportation cost using the 80,000 pound carload weight basis to the railway receiving point nearest the Joint Property for which published rail rates for tubular goods exist. If the 80,000 pound rail rate is not offered, the 70,000 pound or 90,000 pound rail rate may be used. Freight charges for tubing will be calculated from Lorain, Ohio and casing from Youngstown, Ohio.
- (b) For grades which are special to one mill only, prices shall be computed at the mill base of that mill plus transportation cost from that mill to the railway receiving point nearest the Joint Property as provided above in Paragraph 2.A.(1)(a). For transportation cost from points other than Eastern mills, the 30,000 pound Oil Field Haulers Association interstate truck rate shall be used.
- (c) Special end finish tubular goods shall be priced at the lowest published out-of-stock price, f.o.b. Houston, Texas, plus transportation cost, using Oil Field Haulers Association interstate 30,000 pound truck rate, to the railway receiving point nearest the Joint Property.
- (d) Macaroni tubing (size less than 2? inch OD) shall be priced at the lowest published out-of-stock prices f.o.b. the supplier plus transportation costs, using the Oil Field Haulers Association interstate truck rate per weight of tubing transferred, to the railway receiving point nearest the Joint Property.

(2) Line Pipe

- (a) Line pipe movements (except size 24 inch OD and larger with walls $\frac{3}{4}$ inch and over) 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain, Ohio.
 - (b) Line pipe movements (except size 24 inch OD and larger with walls $\frac{3}{4}$ inch and over) less than 30,000 pounds shall be priced at Eastern mill published carload base prices effective as of date of shipment, plus 20 percent, plus transportation costs based on freight rates as set forth under provisions of tubular goods pricing in Paragraph A.(1)(a) as provided above. Freight charges shall be calculated from Lorain, Ohio.
 - (c) Line pipe 24 inch OD and over and $\frac{3}{4}$ inch wall and larger shall be priced f.o.b. the point of manufacture at current new published prices plus transportation cost to the railway receiving point nearest the Joint Property.
 - (d) Line pipe, including fabricated line pipe, drive pipe and conduit not listed on published price lists shall be priced at quoted prices plus freight to the railway receiving point nearest the Joint Property or at prices agreed to by the Parties.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint Property.
- (4) Unused new Material, except tubular goods, moved from the Joint Property shall be priced at the current new price, in effect on date of movement, as listed by a reliable supply store nearest the Joint Property, or point of manufacture, plus transportation costs, if applicable, to the railway receiving point nearest the Joint Property. Unused new tubulars will be priced as provided above in Paragraph 2 A (1) and (2).

B. Good Used Material (Condition B)

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

(1) Material moved to the Joint Property

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

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

- (a) At seventy-five percent (75%) of current new price, as determined by Paragraph A, if Material was originally charged to the Joint Account as new Material or
- (b) At sixty-five percent (65%) of current new price, as determined by Paragraph A, if Material was originally charged to the Joint Account as used Material.

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

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

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

C. Other Used Material

(1) Condition C

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

Section IV.

The tubular goods provision has been substantially modified. The pricing procedure now conforms to the general industrial pricing methods using Eastern Mills as the basing point. General Electric is developing a computerized pricing system for COPAS which will soon be available. The loading and unloading charge has been increased to \$.25 per hundred weight on all tubular goods and this amount fluctuates in accordance with the procedure established in Section III.1.A.(3).

(2) Condition D

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

- (a) Casing, tubing, or drill pipe used as line pipe shall be priced as Grade A and B seamless line pipe of comparable size and weight. Used casing, tubing or drill pipe utilized as line pipe shall be priced at used line pipe prices.
- (b) Casing, tubing or drill pipe used as higher pressure service lines than standard line pipe, e.g. power oil lines, shall be priced under normal pricing procedures for casing, tubing, or drill pipe. Upset tubular goods shall be priced on a non upset basis.

(3) Condition E

Junk shall be priced at prevailing prices. Operator may dispose of Condition E Material under procedures normally utilized by Operator without prior approval of Non-Operators.

D. Obsolete Material

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

E. Pricing Conditions

- (1) Loading or unloading costs may be charged to the Joint Account at the rate of twenty-five cents (25¢) per hundred weight on all tubular goods movements, in lieu of actual loading or unloading costs sustained at the stocking point. The above rate shall be adjusted as of the first day of April each year following January 1, 1985 by the same percentage increase or decrease used to adjust overhead rates in Section III, Paragraph 1.A(3). Each year, the rate calculated shall be rounded to the nearest cent and shall be the rate in effect until the first day of April next year. Such rate shall be published each year by the Council of Petroleum Accountants Societies.
- (2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

3. Premium Prices

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

4. Warranty of Material Furnished By Operator

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

V. INVENTORIES

The Operator shall maintain detailed records of Controllable Material.

1. Periodic Inventories, Notice and Representation

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

2. Reconciliation and Adjustment of Inventories

Adjustments to the Joint Account resulting from the reconciliation of a physical inventory shall be made within six months following the taking of the inventory. Inventory adjustments shall be made by Operator to the Joint Account for overages and shortages, but, Operator shall be held accountable only for shortages due to lack of reasonable diligence.

3. Special Inventories

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

4. Expense of Conducting Inventories

- A. The expense of conducting periodic inventories shall not be charged to the Joint Account unless agreed to by the Parties.
- B. The expense of conducting special inventories shall be charged to the Parties requesting such inventories, except inventories required due to change of Operator shall be charged to the Joint Account.

Section V.

Two revisions have been made in the 1984 COPAS. Section V.2. now compels the Operator to make inventory adjustments within six months of the inventory. In the event of a change of Operator, all parties shall be governed by a special inventory (Section V.3.) and the cost shall be charged to the Joint Account (Section V.4.B.).

EXHIBIT "D"
TO OPERATING AGREEMENT

INSURANCE

**EXHIBIT D
TO OPERATING AGREEMENT**

INSURANCE

1. **COVERAGE**

1.1 Operator shall carry or provide for the benefit of the Joint Account of the parties the types and amounts of Insurance as are shown below:

- (a) Workmen's Compensation Insurance to cover full liability under the Workmen's Compensation Law of the State where the operations are being conducted.
- (b) Employer's Liability Insurance with a limit of not less than \$500,000 for accidental injuries or deaths of one or more employees as a result of one accident.
- (c) Comprehensive General Liability Insurance with limits of not less than \$500,000 Combined Single Limit Per Occurrence for both Bodily Injury and Property Damage.
- (d) Automobile Public Liability Insurance with limits of not less than \$500,000 Combined Single Limit Per Occurrence for both Bodily Injury and Property Damage.

2. **PREMIUMS AND ADDITIONAL COVERAGE**

2.1 The premiums paid for all such Insurance except Automobile shall be charged as operation expense. No Insurance, other than that shown above, shall be carried for the benefit of the Joint Account except by mutual consent of the parties.

EXHIBIT E
TO OPERATING AGREEMENT
GAS BALANCING AGREEMENT

Until fairly recently, gas balancing issues were not a problem. Parties who found gas were generally able to obtain a market to sell their gas and the prices received were similar if not identical. In late 1981, the combination of the movement from energy regulation to deregulation and the growing oversupply, due to conservation, conversion, competition and the successes of the late 1970s and early 1980s, significantly impacted the marketing of gas. No longer was a producer ensured of a market to sell its gas and the price of gas was no longer stable.

Frequently, those that object to the incorporation of a Gas Balancing Agreement will argue that page 8 alternate circumvents the necessity of a Gas Balancing Agreement. Page 8 alternative does no more than give the Operator the right to purchase or sell a Non-Operator's gas upon 30 days notice. Page 8 assumes that the parties have incorporated a Gas Balancing Agreement and does not give the Operator the right to purchase or sell a Non-Operator's gas. Page 8 alternate establishes a symmetry between oil and gas, which does not exist if page 8 is used. Page 8 alternate is simply not a substitute for a Gas Balancing Agreement.

Article VI.C. of the JOA provides that each party has the right to take in kind or separately dispose of its proportionate share of the oil and gas production, subject to the payment of any extra expenditure incurred in taking in kind or separate disposition. As previously discussed, for antitrust and tax reasons, joint marketing is strictly limited. If the Non-Operators cannot or do not wish to market their gas, the Operator has the right, but not the obligation, to purchase or sell the Non-Operator's gas.

The Operator's right to purchase or sell a Non-Operator's gas is strictly limited for "such reasonable periods of time as one consistent with the minimum needs of the industry under the particular circumstances, but in no event for a period in excess of one (1) year." This rule is an outgrowth of the Supreme Court's decision in Morrissey v. Commissioner, 296 U.S. 344 (1935). In Morrissey the Court delineated the five essential characteristics of a corporation, which placed in doubt whether a JOA resulted in an association taxable as a corporation. In light of Morrissey, the Internal Revenue Service issued a ruling which, inter alia, stated that for an association to be a taxable corporation, it must have a joint profit motive. The JOA now incorporates the safe harbor rule provided by the Internal Revenue Service. I.T. 3930, 1948-2 C.B. 126; I.T. 3948, 1949-I C.B. 161.

While oil is customarily sold under short-term contracts, which are revocable by the purchaser or the seller, gas has historically been sold on a long-term basis. Majors and large independents have greater negotiating leverage and thus, have a better chance of finding a market for their gas. The smaller independents now seek to contractually bind the Operator, who is

frequently a major or large independent, into marketing their gas or into assisting in the marketing of their gas.

Mr. Heaney, in an article that appeared in the Mineral Law Institute, argues that the Non-Operator should have the option of taking in kind, selling its gas or requiring the Operator to market the gas for the account of the Non-Operator. Mr. Heaney states "it is more in the spirit of the relationship between the parties, as well as reflecting customary practice for investors financial operations, that all of the parties share proportionately in each sale of production." J. David Heaney, Joint Operating Agreements, The AFE and COPAS - What They Fail to Provide, 29 Rocky Mtn. Min. L. Inst. 743, 777 (1983).

Although small independents and investor groups pressure Operators to market or assist in the marketing of their gas, it would be an error for an Operator to comply with such a request. Operators that market Non-Operator's gas in excess of one year risk being characterized by the Internal Revenue as having a joint profit motive for the reasons discussed previously, and such characterization could adversely affect the parties' tax position. In addition, joint marketing could be the subject of a Sherman Act antitrust allegation. Section 1 of the Sherman Act prohibits conspiracies to restrain trade, and it could be argued that parties who jointly market are restraining trade by conspiring to fix the price of gas from a well bore. Finally, there are practical problems that arise from agreeing to jointly market or even to assist in the marketing of a Non-Operator's gas. For example, what if an Operator agrees in writing to market or use its best efforts to market a Non-Operator's gas. The Non-Operator then sells its interest to 40 investors on the strength of the Operator's representation that it will market or use its best efforts to market the Non-Operator's gas. And, the Operator is not able to sell the Non-Operator's gas. Under this example, the Operator is exposed to a lawsuit by the 40 investors.

A working interest owner who cannot market its gas must generally rely on the state's common law remedy. However, the states of Mississippi and Oklahoma have attempted to order the sharing of a gas market equally among the working interest owners. The Mississippi State Oil and Gas Board ordered gas purchasers to start taking gas ratably (ie. in proportion to the various owners' shares) from the gas pool, and to purchase the gas under non-discriminatory price and take-or-pay conditions. The Supreme Court, in a decision written by Justice Blackmun, ruled that the Mississippi State Oil and Gas Board acted improperly in ordering a ratable-take and that such action was preempted by the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978. Transcontinental Gas Pipe Line Corporation v. State Oil and Gas Board of Mississippi and Coastal Exploration, Inc., 106 U.S. 709 (1986). The Oklahoma Supreme Court upheld the constitutionality of Enrolled House Bill No. 1221, codified as Okla. Stat. tit. 52, §§ 542-547 (Supp. 1983), which

mandates that electing owners who do not have a gas contract are entitled to share ratably in the revenue received from those owners who have gas contracts, to the extent of their net revenue interest. The court, however, restricted the application of the statute only to owners who have not agreed "otherwise". The court recognized that a JOA, at least one which contains a Gas Balancing Agreement, constitutes an agreement "otherwise". Consequently, 1221 revenue sharing is mandated in only a minority of situations. Dennis E. Seal v. Corporation Commission, Consolidated Case No. 61636, *The Oklahoma Bar Journal* 1485 (June 17, 1986). Although ratable take statutes requiring that purchasers from a pool take gas ratably among the wells producing from the pool and the producers in those wells without discrimination, state action has been stifled by claims of federal preemption and unconstitutionality, See Mississippi State Oil and Gas Board Statewide Rule 48; Kan. Stat. Ann. § 55-703 (Supp. 1982); Colo. Rev. Stat. § 34-60-117(4) (1973); Ark. Stat. Ann. § 53-521 (Supp. 1983); Okla. Stat. Ann., tit. 52 §§ 233 and 541 (West 1983, H.B. 1221); Ariz. Rev. Stat. Ann. § 27-508.01 A. (1956); N.D. Cent. Code § 49-19-11 (1959); Tex. Stat. Ann., art. 111.086 (1978); N.M. Stat. Ann., § 70-2-19 (Supp. 1983); La. Rev. Stat. Ann. § 30:42 (West 1975); Alaska Stat. §§ 31.15.010, 31.15.030 (1983).

In the absence of a Gas Balancing Agreement, parties who are unable to market their gas have an equitable right to balance in kind or in cash to the extent of their share of production which they did not recover. Courts have characterized this concept as "equitable gas balancing." See United States Petroleum Exploration, Inc., v. Premier Resources, Ltd., 511 F. Supp. 127 (W.D. Okla. 1980); Beren v. Harper Oil Co., 546 P.2d 1356 (Okla. Ct. App. 1975). Professor Kuntz states that there are three methods to correct inbalancing; (1) Balancing in kind or balancing volumes, (2) balancing in cash, periodically, and (3) balancing in cash, upon depletion of the reservoir. E. Kuntz, The Law of Oil and Gas, § 77.3(f) (1978).

In United Petroleum Exploration, Inc. v. Premier Resources, Ltd., the court refused to allow United as an underproduced party to balance in kind. United sought an order which would have allowed it to balance in kind and by so doing capitalize on the increase in gas prices. The court citing Professor Kuntz states "it has been judicially recognized that the general custom in the industry is to balance in kind, if possible, but it has been held that cash balancing is proper and should be ordered when the well is depleting and the cause of the imbalance has been removed."

Glenn Taylor, in an article in *The Institute on Oil and Gas Law*, astutely points out that the courts in neither the United Petroleum Exploration, Inc. v. Premier Resources, Ltd. nor the Beren v. Harper Oil Co. cases address the question of balancing in the context of current market problems. Today gas from a

well bore is sold at different prices and the current glut has made it impossible for some producers to market their gas at any price. If an imbalance occurs, the obligation to cash balance can be determined on the basis of (1) the proceeds received by the overproduced parties, (2) the price that the underproduced parties theoretically would have received had they had a gas contract, or (3) the market price. Taylor, The Excess Gas Market – Recent Legal Problems Precipitated by Excess Gas Deliverability, and Applicable Regulatory Provisions, 35th Inst. on Oil & Gas L. 87 (1984). The most equitable manner balances on the proceeds received by the overproduced parties.

Perhaps it is the word "equitable" in the concept of "equitable gas balancing" which should govern how balancing should occur. An underproducer should get its fair share, but not necessarily at the expense of an overproducer. If the underproducer did not diligently market its gas or refused to execute a gas contract in the hope that gas prices would rise, the equities would not favor the underproducer. Conversely, if the underproducer diligently sought to market its gas, but due to market forces it was unable to sell its gas and the well's depletion ratio would not permit balancing, the equities would be different. One thing is certain, however, parties who drill without Gas Balancing Agreements run the risk that an imbalance will occur and they will be sucked into the quagmire of allowing a court to define the respective rights and obligations of the parties.

**EXHIBTT E
TO OPERATING AGREEMENT**

GAS BALANCING AGREEMENT

Notwithstanding anything to the contrary in this Operating Agreement, if any party hereto takes and disposes of less than its percentage interest share of gas (including casinghead gas) produced and saved during any calendar month, then the volume not taken by such party may be taken during that month by the other parties hereto in proportion to their percentage interests or such other proportions as they may agree upon among themselves, and the following provisions shall apply:

(a) **Definitions.** For the purposes hereof, the term "Cumulative Underlift" means the amount by which the cumulative volume of gas taken by a party is less than the cumulative volume that party is entitled to take according to its percentage interest; the term "Cumulative Overlift" means the amount by which the cumulative volume of gas taken by a party exceeds the cumulative volume that party is entitled to take according to its percentage interest; the term "Underlifter" means a party credited with Cumulative Underlift; the term "Overlifter" means a party charged with Cumulative Overlift; and the term "Make-Up Gas" means the volume of gas taken by an Underlifter to make up Cumulative Underlift pursuant to Paragraph (c) below.

(b) **Operator's Statements.** On or before the end of each calendar month, Operator shall furnish the parties hereto a statement showing the total volume of gas taken by each party during the preceding month, the Make-Up Gas taken by each party during that month, the cumulative volume taken by each party as of the end of that month, and the Cumulative Underlift or Cumulative Overlift, if any, of each party as of the end of that month.

(c) **Current Balancing.** By giving written notice to Operator and all other parties hereto at least 15 days before the beginning of a calendar month, an Underlifter shall be entitled to take during that month its full percentage interest share of gas plus a volume of Make-Up Gas equal to its Cumulative Underlift, provided that to accommodate such make-up no party (including an Overlifter) shall ever be required to take less than 75% of its percentage interest share of gas during the month, and provided that the right to take Make-Up Gas shall be subordinate to the right of any party to take its full percentage interest share of gas from time to time in order to satisfy the deliverability test requirements of its gas contract. If two or more Underlifters desire to take Make-Up Gas during the same month and the combined volume they desire to take exceeds the volume available as Make-Up Gas, the volume available as Make-Up Gas shall be shared by such Underlifters in proportion to their Cumulative Underlifts. Make-Up Gas taken by Underlifters during the month shall be deducted from the volumes the other parties hereto would otherwise be entitled to take hereunder, in proportion to the Cumulative Overlifts of such other parties, subject to the other provisions of this Paragraph (c). Make-Up Gas volumes shall be applied against Cumulative Underlifts and Cumulative Overlifts on a first-in-first-out basis.

(d) **Storage Charges.** Whenever an Underlifter takes Make-Up Gas, the Underlifter shall pay a cash storage charge to each Overlifter whose Cumulative Overlift is reduced by the make-up. The storage charge shall be equal to the volume by which the Overlifter's Cumulative Overlift is reduced, times the amount, if any, by which the current value of the gas exceeds the inflation-adjusted value of the gas. It is understood that when the inflation-adjusted value of the gas exceeds the current value of the gas, no charge will be payable by either the Underlifter or the Overlifter. The "current value" of the gas shall be the weighted average price the Overlifter would have received for such gas if it had been sold by the Overlifter in an arm's-length sale during the month it is taken as Make-Up Gas, less taxes that would have been paid by the Overlifter pursuant to Paragraph (f) below. The "inflation-adjusted value" of the gas shall be the weighted average price the Overlifter actually received for such gas in an arm's-length sale during the month it accrued as Cumulative Overlift, less taxes paid by the Overlifter pursuant to Paragraph (f) below, and adjusted quarterly for changes in the GNP implicit price deflator between the first day of the month in which the gas accrued as Cumulative Underlift and the first day of the month in which it is taken as Make-Up Gas. For this purpose, "GNP implicit price deflator" shall be as defined in §101(a) of the Natural Gas Policy Act of 1978 as of the date of this Agreement. In the absence of an arm's-length sale by the Overlifter, gas values shall be determined using the highest weighted average price received by any party to this Agreement in an arm's-length sale during the month in question. Storage charges shall be paid by the Underlifter within 30 days after receipt of invoice from the Overlifter, showing the gas values and inflation adjustments used to calculate such charge.

(e) **Final Balancing.** If this Agreement should terminate or if gas production hereunder should permanently cease before all parties have achieved balance under Paragraph (c) above, then final balancing shall be achieved through a cash settlement (without interest) between the Overlifters and Underlifters. Operator's final monthly statement shall show each party credited with Cumulative Underlift and each party charged with corresponding Cumulative Overlift. Within 30 days after receipt of such final statement, each Overlifter shall pay to the appropriate Underlifter(s) a cash sum equal to the value of such corresponding Cumulative Overlift. For this purpose, "value" means the price the Overlifter actually received for the gas in an arm's-length sale during the month it accrued as Cumulative Overlift, less all applicable payments made by the Overlifter pursuant to Paragraph (f) below. In the absence of an arm's-length sale by the Overlifter, value shall be determined using the highest weighted average price received by any party to this Agreement in an arm's-length sale during the month in question. To the extent any value used to calculate a cash settlement hereunder is subject to refund by the Overlifter pursuant to orders or regulations of any state or federal authority having jurisdiction over gas prices, the Underlifter entitled to such cash settlement shall, prior to payment thereof, indemnify the Overlifter against the Underlifter's proportionate part of any refund (including interest) which the Overlifter shall be required to make.

(f) **Payments on Production.** Each party shall pay all production or severance taxes, excise taxes, royalties, overriding royalties, production payments and other such payments for which it is obligated by law or by lease or by contract (including other provisions of this Agreement), and nothing in these gas balancing provisions shall be construed as affecting such obligations. Each party hereto shall indemnify and hold harmless the other parties hereto against all claims, losses or liabilities arising out of its failure to fulfill such obligations.

(g) **Costs and Expenses.** Regardless of the volume of gas actually taken by any party hereto, each such party shall bear costs and expenses as otherwise provided in this Agreement.

(h) **Oil and Other Minerals.** Regardless of the volume of gas actually taken by any party hereto, each such party shall share in the production of crude oil, condensate and other minerals separated from the gas in facilities operated for the joint account, as otherwise provided in this Agreement.

A variety of different Gas Balancing Agreements are customarily being used. The form provided is similar to the forms used. This form, however, contains a storage charge. In accordance with this provision, if the price of gas increases above the inflation-adjusted value (as defined) between the time the overproduced party sells his gas and the time the underproduced party sells its gas, any appreciation above the inflation-adjusted value is to be earned by the overproduced party. Simply stated, this provision provides monetary disincentives for parties to withhold selling their gas in the hope that gas prices will increase.

Also note that paragraph (f) states that "[E]ach party is only liable for its production or severance taxes, excise taxes, royalties, overriding royalties, production payments and other such payments for which it is obligated by law or by contract (including other provisions of this Agreement), and nothing in these gas balancing provisions shall be construed as affecting such obligations." Occasionally, Gas Balancing Agreements provide that royalty payments are to be made whether or not the party is selling or taking its gas. These provisions are known as out-of-pocket royalty provisions. Out-of-pocket royalty provisions require the payment of royalties, but at what price? If the price increases, must the underproduced party pay the royalty owner the difference between the out-of-pocket royalty paid and the royalty predicated on the amount actually received? Should the underproduced party pay interest on this amount and at what rate? What if the price decreases? Should the royalty owner pay the underproduced party the difference between the out-of-pocket royalty paid and the royalty predicated on the amount actually received? Should the royalty interest owner pay interest on this amount and at what rate?

Some companies incorporate out-of-pocket royalty provisions fearing that they may lose leases if all the royalty owners within a given drilling and spacing unit are not being paid royalties, whether or not any particular royalty owner's lessee is currently selling any gas. See Fell, Marketing of Production from Properties Subject to Operating Agreements, 33 Inst. on Oil & Gas L. 115 (1982), where Mr. Fell in his concluding remarks suggests that royalty obligation should be paid whether the party is or is not selling its share of the gas. Other companies have concluded that this is not a problem. They argue that the lease is the only relevant agreement between the lessor and the lessee, that the lessor-lessee rights are not affected by a Gas Balancing Agreement, and that the lease requires royalties to be paid when the lessee produces oil and or gas. If the lessee is not producing oil and or gas, the lessee does not owe royalties. The payment of out-of-pocket royalties can be an accounting nightmare and before such agreement is adopted, the parties should ensure that their system can actually handle the payment of out-of-pocket royalties. Many systems cannot.

EXHIBIT E
TO OPERATING AGREEMENT
GAS BALANCING AGREEMENT
(ONSHORE)

1. Gas Imbalances.

Notwithstanding anything to the contrary in the Operating Agreement to which this Gas Balancing Agreement is attached, if any party hereto takes and disposes of less than its percentage interest share of gas (including casinghead gas) produced and saved during any calendar month, then the volume not taken by such party may be taken by any other party or parties hereto. If such volume is taken by more than one party, then each taking party shall be entitled to take the proportion thereof that its percentage interest bears to the sum of the percentage interests of all taking parties, or in such other proportions as the taking parties may agree upon among themselves.

2. Gas Balancing.

2.1 Applicability. This Paragraph 2 shall apply separately to each category established by law, regulation or governmental order for the purpose of regulating or deregulating the price of gas, including but not limited to categories established by the Natural Gas Policy Act of 1978 and regulations or orders of the Federal Energy Regulatory Commission. In the event a category is revised, the category as revised shall be considered a new and separate category.

2.2 Definitions. The term "Cumulative Underproduction" means the amount by which the cumulative volume of gas taken by a party within a particular category is less than the cumulative volume that party was entitled to take within such category according to its percentage interest; the term "Cumulative Overproduction" means the amount by which the cumulative volume of gas taken by a party within a category exceeds the cumulative volume that party was entitled to take within such category according to its percentage interest; the term "Underproducer" means a party credited with Cumulative Underproduction; the term "Overproducer" means a party charged with Cumulative Overproduction; and the term "Make-Up Gas" means the volume taken by an Underproducer to make up Cumulative Underproduction pursuant to Paragraph 2.4 below.

2.3 Operator's Statements. On or before the end of each calendar month, Operator shall furnish the parties hereto a written statement showing for each category (a) the total volume of gas taken by each party during the preceding calendar month; (b) the Make-Up Gas taken by each party during that month; (c) the cumulative volume of gas taken by each party as of the end of that month; and (d) the Cumulative Overproduction or Cumulative Underproduction, if any, of each party as of the end of that month.

2.4 Volumetric Balancing. By giving written notice to Operator and all other parties hereto at least 15 days before the beginning of a calendar month, an Underproducer shall be entitled to take during that month, in addition to its full percentage interest share of gas, a volume of Make-Up Gas equal to its Cumulative Underproduction, provided that to accommodate such make-up no other party (including an Overproducer) shall ever be required to take less than 75% of its percentage interest share of gas during the month, and provided that the right to take Make-Up Gas shall be subordinate to the right of any other party to take its full percentage interest share of gas from time to time to satisfy the deliverability test requirements of its gas contract. If two or more Underproducers desire to take Make-Up Gas during the same month and the combined volume they desire to take exceeds the volume available as Make-Up Gas, the volume available as Make-Up Gas shall be shared by such Underproducers in proportion to their respective Cumulative Underproduction. Subject to the 75% limitation specified above, the volume taken as Make-Up Gas during the month shall be deducted from the volumes the Overproducers would otherwise be entitled to take, and such deduction shall be in proportion to their respective Cumulative Overproduction. Make-Up Gas volumes shall be applied against Cumulative Underproduction and Cumulative Overproduction on a first-in-first-out basis.

2.5 Oil and Other Minerals. Regardless of the volume of gas actually taken by any party hereto, such party shall share, as otherwise provided in the Operating Agreement, in the production of crude oil, condensate and other minerals separated from the gas in facilities operated for the joint account.

2.6 Costs and Expenses. Regardless of the volume of gas actually taken by any party hereto, such party shall bear costs and expenses as otherwise provided in the Operating Agreement.

3. Final Cash Balancing.

3.1 Statements. If all parties have not achieved volumetric gas balance in all categories upon termination of the Operating Agreement or upon a permanent cessation of all gas production thereunder, Operator shall furnish to all parties a statement showing the final Cumulative Overproduction and Cumulative Underproduction of each party by category, and the month and year in which it accrued. Within 60 days after receipt of Operator's statement, each Overproducer shall furnish to all other parties a statement showing the value of its Cumulative Overproduction for each category, based on the price the Overproducer actually received for the gas in a sale to a Nonaffiliate during the month(s) in which the Cumulative Overproduction accrued, less all payments made by the Overproducer pursuant to Paragraph 4 below. In the absence of a sale to a Nonaffiliate, value shall be based on the highest price received by any party hereto in a sale to a Nonaffiliate during the month in question. For the purpose of this agreement, the term "Nonaffiliate" as it relates to a party means any corporation or other business organization not in control of, and not controlled by, and not under common control with, such party. Based upon the statements furnished by Overproducers, the net amount owed by or to each party for all categories combined shall be calculated by Operator and furnished to all parties in a final cash balancing statement.

3.2 Settlements. Within 60 days after receipt of Operator's final cash balancing statement, each Overproducer shall pay each Underproducer in accordance with the statement and without interest. To the extent any value used to calculate a cash settlement hereunder is subject to refund by the Overproducer pursuant to law, regulation or governmental order, the Underproducer entitled to such cash settlement shall, prior to payment thereof, agree in writing to indemnify the Overproducer against the Underproducer's proportionate part of any refund (including interest) which the Overproducer shall be required to make. Any party may challenge any volumes or values or amounts specified in any of the statements furnished under Paragraph 2.3 or 3.1 above, in the same manner and subject to the same limitations as an invoice from Operator may be challenged under the Operating Agreement or the accounting procedure thereto.

4. Payments on Production.

Each party shall pay all production or severance taxes, excise taxes, royalties, overriding royalties, production payments and other such payments on production for which it is obligated by law or by lease or by contract (including the Operating Agreement), and nothing in this Gas Balancing Agreement shall be construed as affecting such obligations. Each party hereto agrees to indemnify and hold harmless the other parties hereto against all claims, losses or liabilities arising out of its failure to fulfill such obligations.

This form is nearly identical to the prior discussed Gas Balancing Agreement with two exceptions. The storage charge paragraph has been removed and balancing is to occur on a vintaging basis. Paragraphs 2.2 and 3.1 mandate balancing by category. Balancing by vintaging discourages the manipulation of a party's gas sales to exploit the differing price categories of the National Gas Policy Act at the expense of those parties who market their gas.

EXHIBIT "F"

TO OPERATING AGREEMENT

NON-DISCRIMINATION AND CERTIFICATE
OF NON-SEGREGATED FACILITIES

EXHIBIT "F"
TO OPERATING AGREEMENT

NON-DISCRIMINATION AND CERTIFICATE OF NON-SEGREGATED FACILITIES

The Federal Government mandates that companies that do business with it, comply with the Government's Non-Discrimination and Non-Segregated Facilities orders and laws.

To substantiate that all parties to the JOA are in compliance with these orders and laws, it is recommended that this form or some variation thereof be incorporated.

EXHIBIT F
TO OPERATING AGREEMENT

NON-DISCRIMINATION AND CERTIFICATE OF NON-SEGREGATED FACILITIES

1. Operator and Non-Operators, hereinafter called "contractor/supplier", hereby agree that the following, if applicable, shall apply to this Operating Agreement and all activities conducted hereunder:

A. EQUAL OPPORTUNITY CLAUSE [Applicable to contracts amounting to \$10,000 or more, 41 CFR 60-1.4.]

The equal opportunity clause required by Executive Order 11246 of September 24, 1965, and prescribed in Section 60-1.4 of Title 41 of the Code of Federal Regulations is incorporated by reference (as permitted by Section 60-1.4(d) of said Regulation) as if set out in full at this point.

B. AFFIRMATIVE ACTION COMPLIANCE PROGRAM [Applicable to contracts amounting to \$50,000 or more only if contractor/supplier has 50 or more employees, 41 CFR 60-1.40.]

If required under 41 CFR Sec. 60-1.40, contractor/supplier affirms that it has developed and is maintaining current an affirmative action program at each of its establishments or that if such a program has not been established, that it will be within 120 days of receipt of any contract of \$50,000 or more. Contractor/supplier shall maintain such program until such time as it is no longer required by law or regulation.

C. EQUAL EMPLOYMENT OPPORTUNITY REPORTING REQUIREMENTS [Applicable to contracts amounting to \$50,000 or more only if contractor/supplier has 50 employees or more, 41 CFR 60-1.7.]

If required under 41 CFR Sec. 60-1.7, contractor/supplier agrees to file a complete and accurate report on Standard Form 100 (EEO-1) within thirty (30) days of the date of contract or purchase order award unless such a report has been filed in the last twelve (12) months and agrees to file such reports annually unless and until contractor/supplier is not required to so file by law or regulation.

D. EMPLOYMENT OF THE HANDICAPPED [Applicable to contracts amounting to \$2,500 or more, 41 CFR 60-741.4.]

The affirmative action clause prescribed in Section 60-741.4 of Title 41 of the Code of Federal Regulations is incorporated herein by reference (as permitted by Section 60-741.22 of said Regulations) as if set out in full at this point.

E. AFFIRMATIVE ACTION PROGRAM FOR HANDICAPPED WORKERS [Applicable to contracts amounting to \$2,500 or more only if contractor/supplier (a) has 50 or more employees and (b) holds a contract of \$50,000 or more, 41 CFR 60-741.5.]

If required under 41 CFR 60-741.5, contractor/supplier affirms that it has prepared and is maintaining or shall prepare and maintain an affirmative action program for handicapped workers as prescribed in 41 CFR 60-741.5 and 41 CFR 60-741.6.

F. EMPLOYMENT OF DISABLED VETERANS AND VETERANS OF THE VIETNAM ERA [Applicable to contracts amounting to \$10,000 or more, 41 CFR 60-250.4.]

The affirmative action clause prescribed in Section 60-250.4 of Title 41 of the Code of Federal Regulations is incorporated by reference (as permitted by Section 60-250.22 of said Regulations) as if set out in full at this point.

G. AFFIRMATIVE ACTION PROGRAM FOR DISABLED VETERANS AND VETERANS OF THE VIETNAM ERA [Applicable to contracts amounting to \$10,000 or more only if contractor/supplier (a) has 50 or more employees and (b) holds a contract of \$50,000 or more, 41 CFR 60-250.5.]

If required under 41 CFR 60-250.5, contractor/supplier affirms that it has prepared and is maintaining or shall prepare and maintain an affirmative action program for disabled veterans and veterans of the Vietnam era.

H. UTILIZATION OF MINORITY BUSINESS ENTERPRISES [Applicable to contracts amounting to \$10,000 or more, 41 CFR Sec. 1-1.1310-2(a).]

It is the policy of the United States Government that minority business enterprises shall have the maximum practicable opportunity to participate in the performance of Government contracts.

Contractor/supplier agrees to use its best efforts to carry out this policy in the award of its subcontracts to the fullest extent consistent with the efficient performance of this contract. As used in this contract, the term "minority business enterprise" means a business, at least 50 percent of which is owned by minority group members or, in case of publicly owned businesses, at least 51 percent of the stock of which is owned by minority group members. For the purpose of this definition, minority group members are Negroes, Puerto Ricans, Spanish-speaking American people, American Orientals, American Indians, American Eskimos, and American Aleuts. Contractor/supplier may rely on written representations by subcontractors regarding their status as minority business enterprises in lieu of independent investigation.

I. MINORITY BUSINESS ENTERPRISES SUBCONTRACTING PROGRAM [Applicable to all contracts which may exceed \$500,000 which contain the clause required by 41 CFR 1-1.1310-2(a) and which offer substantial subcontracting possibilities, 41 CFR 1-1.1310-2(b).]

1. Contractor/supplier agrees to establish and conduct a program which will enable minority business enterprises (as defined in the above clause entitled "Utilization of Minority Business Enterprises") to be considered fairly as subcontractors and suppliers under this contract. In this connection, contractor/supplier shall:

(a) Designate a liaison officer who will administer contractor/supplier's minority business enterprises program.

(b) Provide adequate and timely consideration of the potentialities of known minority business enterprises in all "make-or-buy" decisions.

(c) Assure that known minority business enterprises will have an equitable opportunity to compete for subcontracts, particularly by arranging solicitations, time for the preparation of bids, quantities, specifications, and delivery schedules so as to facilitate the participation of minority business enterprises.

(d) Maintain records showing (i) procedures which have been adopted to comply with the policies set forth in this clause, including the establishment of a source list of minority business enterprises, (ii) awards to minority business enterprises on the source list, and (iii) specific efforts to identify and award contracts to minority business enterprises.

(e) Include the above "Utilization of Minority Business Enterprises" clause in subcontracts which offer substantial minority business enterprises subcontracting opportunities.

(f) Cooperate with the Contracting Officer in any studies and surveys of contractor/supplier's minority business enterprises procedures and practices that the Contracting Officer may from time to time conduct.

(g) Submit periodic reports of subcontracting to known minority business enterprises with respect to the records referred to in subparagraph (d) above, in such form and manner and at such time (not more often than quarterly) as the Contracting Officer may prescribe.

2. Contractor/supplier further agrees to insert, in any subcontract hereunder which may exceed \$500,000, provisions which shall conform substantially to the language of this clause, including this paragraph (2), and to notify the Contracting Officer of the names of such subcontractors.

J. UTILIZATION OF WOMEN-OWNED BUSINESS CONCERNS [Applicable to contracts amounting to \$10,000 or more, Federal Register, Vol. 45, No. 92, 5/9/80.]

It is in the policy of the United States Government that women-owned businesses shall have the maximum practicable opportunity to participate in the performance of contracts awarded by any Federal agency.

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

K. WOMEN-OWNED BUSINESS SUBCONTRACTING PROGRAM [Applicable to contracts amounting to \$500,000 or more, Federal Register, Vol. 45, No. 92, 5/9/80.]

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

(a) Designate a liaison officer who will administer the contractor/supplier's "Women-Owned Business Concerns Program".

(b) Provide adequate and timely consideration of the potentialities of known women-owned business concerns in all "make-or-buy" decisions.

(c) Develop a list of qualified bidders that are women-owned businesses and assure that known women-owned business concerns have an equitable opportunity to compete for subcontracts, particularly by making information on forthcoming opportunities available, by arranging solicitations, time for the preparation of bids, quantities, specifications, and delivery schedules so as to facilitate the participation of women-owned business concerns.

(d) Maintain records showing (i) procedures which have been adopted to comply with the policies set forth in this clause, including the establishment of a source list of women-owned business concerns, (ii) awards to women-owned businesses on the source list by minority and non-minority women-owned business concerns, and (iii) specific efforts to identify and award contracts to women-owned business concerns.

(e) Include the "Utilization of Women-Owned Business Concerns" clause in subcontracts which offer substantial subcontracting opportunities.

(f) Cooperate in any studies and surveys of the contractor/supplier's women-owned business concerns procedures and practices that the Contracting Officer may from time to time conduct.

(g) Submit periodic reports of subcontracting to women-owned business concerns with respect to the records referred to in subparagraph (d) above, in such form and manner and at such time (not more often than quarterly) as the Contracting Officer may prescribe.

2. The contractor/supplier further agrees to insert, in any subcontract hereunder which may exceed \$500,000 or \$1,000,000 in the case of contracts for the construction of any public facility and which offers substantial subcontracting possibilities, provisions which shall conform substantially to the language of this clause, including this paragraph (2), and to notify the Contracting Officer of the names of such subcontractors.

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

L. UTILIZATION OF SMALL BUSINESS CONCERNS AND SMALL BUSINESS CONCERNS OWNED AND CONTROLLED BY SOCIALLY AND ECONOMICALLY DISADVANTAGED INDIVIDUALS [Applicable to all contracts amounting to \$10,000 or more, Federal Register, Vol. 45, No. 92, 5/9/80.]

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

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

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

2. The term "small business concern owned and controlled by socially and economically disadvantaged individuals" shall mean a small business concern:

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

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

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

Contractor/supplier acting in good faith may rely on written representations by subcontractors as either a small business concern or a small business concern owned and controlled by socially and economically disadvantaged individuals.

M. SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS SUBCONTRACTING PLAN [Applicable to all contracts expected to exceed \$500,000 which are required to include the small business and small disadvantaged business utilization clause above and offer subcontracting possibilities, Federal Register, Vol. 45, No. 92, 5/9/80.]

Contractor/supplier agrees to negotiate a subcontracting plan which includes:

1. Percentage goals (expressed in terms of percentage of total planned subcontracting dollars) for the utilization as subcontractors of small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals. (For the purpose of the subcontracting plan, contractor/supplier shall include all purchases which contribute to the performance of the contract, including a proportionate share of products, services, etc., whose costs are normally allocated as indirect or overhead costs.)

2. The name of an individual within the employ of the offeror who will administer the subcontracting program of the offeror and a description of the duties of such individual.

3. A description of the efforts the offeror will take to assure that small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals will have an equitable opportunity to compete for subcontracts.

4. Assurances that the clause entitled "Utilization of Small Business Concerns and Small Business Concerns Owned and Controlled by Socially and Economically Disadvantaged Individuals" will be included in all subcontracts which offer further subcontracting opportunities and that all subcontractors (except small business subcontractors) who receive subcontracts in excess of \$500,000 will be required to adopt a similar plan. Such assurance shall describe the procedures established by contractor/supplier for review, approval, and monitoring for compliance with such plans.

5. Assurances that contractor/supplier will submit such periodic reports and cooperate in any studies or surveys as may be required by the Small Business Administration to determine its extent of compliance with the subcontracting plan.

6. A recitation of the types of records contractor/supplier will maintain to demonstrate procedures which have been adopted to comply with the requirements and goals set forth in the plan, including source lists of small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals, and efforts to identify and award subcontracts to such small business concerns.

N. UTILIZATION OF LABOR SURPLUS AREA CONCERNS [Applicable to contracts amounting to \$10,000 or more, 41 CFR 1-1.805-3.]

1. It is the policy of the United States Government to award contracts to labor surplus area concerns that agree to perform substantially in labor surplus areas, where this can be done consistent with the efficient performance of the contract and at prices no higher than are obtainable elsewhere. The contractor/supplier agrees to use his best efforts to place his subcontracts in accordance with this policy.

2. In complying with paragraph (1) of this clause and with the second paragraph of the clause of this contract entitled "Utilization of Small Business Concerns and Small Business Concerns Owned and Controlled by Socially and Economically Disadvantaged Individuals", the contractor/supplier in placing his subcontracts shall observe the following order of preference: (a) small business concerns and small business concerns that are owned and controlled by socially and economically disadvantaged individuals that are labor surplus area concerns, (b) other small business concerns and small business concerns that are owned and controlled by socially and economically disadvantaged individuals, and (c) other labor surplus area concerns.

3. The term "labor surplus area" means a geographical area identified by the Department of Labor as an area of concentrated unemployment or underemployment or an area of labor surplus.

4. The term "labor surplus area concern" means a concern that together with its first tier subcontractors will perform substantially in labor surplus areas.

5. The term "perform substantially in labor surplus area" means that the costs incurred on account of manufacturing, production, or appropriate services in labor surplus areas exceed 50 percent of the contract price.

O. LABOR SURPLUS AREA SUBCONTRACTING PROGRAM [Applicable to all contracts which may exceed \$500,000 which are required to include the labor surplus area utilization clause above and offer substantial subcontracting possibilities, 41 CFR 1-1.710-3(b).]

1. The contractor/supplier agrees to establish and conduct a program which will encourage labor surplus area concerns to compete for subcontracts within their capabilities. In this connection, the contractor/supplier shall:

(a) Designate a liaison officer who will (i) maintain liaison with duly authorized representatives of the Government on labor surplus area matters, (ii) supervise compliance with the "Utilization of Concerns in Labor Surplus Areas" clause, and (iii) administer the contractor/supplier's "Labor Surplus Area Subcontracting Program".

(b) Provide adequate and timely consideration of the potentialities of labor surplus area concerns in all "make-or-buy" decisions.

(c) Assure that labor surplus area concerns will have an equitable opportunity to compete for subcontracts, particularly by arranging solicitation, time for the preparation of bids, quantities, specifications, and delivery schedules so as to facilitate the participation of labor surplus area concerns.

(d) Maintain records showing the procedures which have been adopted to comply with the policies set forth in this clause and report subcontract awards (see 41 CFR 1-16.804-5 regarding use of Optional Form 61). Records maintained pursuant to this clause will be kept available for review by the Government until the expiration of one year after the award of this contract, or for such longer periods as may be required by any other clause of this contract or by applicable law or regulations.

(e) Include "Utilization of Concerns in Labor Surplus Areas" clause in subcontracts which offer substantial labor surplus area subcontracting opportunities.

2. The contractor/supplier further agrees to insert, in any subcontract hereunder which may exceed \$500,000 and which contains the "Utilization of Concerns in Labor Surplus Areas" clause, provisions which shall conform substantially to the language of this clause, including this paragraph (2), and to notify the Contracting Officer of the names of such subcontractors.

P. CLEAN AIR AND WATER [Applicable only if the contract exceeds \$100,000 or if it is determined that orders under an indefinite quantity contract in any one year will exceed \$100,000, or a facility to be used has been the subject of a conviction under the Clean Air Act (42 U.S.C. 1857c-8(c)(1)) or the Federal Water Pollution Control Act (33 U.S.C. 1319(c)) and is listed by EPA, or the contract is not otherwise exempt.]

Contractor/supplier agrees as follows:

1. To comply with all the requirements of Section 114 of the Clean Air Act, as amended (42 U.S.C. 1857, et. seq., as amended by Pub. L. 91-604) and section 308 of the Federal Water Pollution Control Act (33 U.S.C. 1251, et. seq., as amended by Pub. L. 92-500), respectively, relating to inspections, monitoring, entry reports, information, as well as other requirements specified in section 114 and section 30 of the Air Act and the Water Act, respectively, and all regulations and guidelines issued thereunder before the award of the contract.

2. That no portion of the work required by this contract will be performed at a facility listed on the Environmental Protection Agency List of Violating Facilities on the date when the contract was awarded unless and until the EPA eliminates the name of such facility or facilities from such listing.

3. To use its best efforts to comply with clean air standards and clean water standards at the facility in which the contract is being performed.

4. To insert the substance of the provisions of this clause into any non-exempt subcontract, including this paragraph.

Q. CLEAN AIR AND WATER CERTIFICATION [Applicable if contract amount exceeds \$100,000, "or the Contracting Officer has determined that orders under an indefinite quantity contract in any year will exceed \$100,000", or a facility to be used has been the subject of a conviction under the Clean Air Act (42 U.S.C. 1857c-8(c)(1)) or the Federal Water Pollution Control Act (33 U.S.C. 1319(c)) and is listed by EPA, or is not otherwise exempt.]

Contractor/supplier certifies as follows:

1. Any facility to be utilized in the performance of the proposed contract has not been listed on the Environmental Protection Agency List of Violating Facilities.

2. Contractor/supplier will promptly notify Contracting Officer, prior to award of the receipt of any communication from the Director, Office of Federal Activities, Environmental Protection Agency, indicating that any facility which contractor/supplier proposes to use for the performance of the contract is under consideration to be listed on the EPA List of Violating Facilities.

3. Contractor/supplier will include substantially this certification, including this paragraph (3), in every non-exempt subcontract.

R. NON-SEGREGATED FACILITIES CERTIFICATION [Applicable if contract amount exceeds \$10,000 (60 C.F.R. 1.8).]

Contractor/supplier certifies that it does not and will not maintain any facilities it provides for its employees in a segregated manner or permit its employees to perform their services at any location under its control where segregated facilities are maintained, and that contractor/supplier will obtain a similar certification in the form approved by the Director, Office of the Federal Contract Compliance Programs, prior to the award of any non-exempt subcontract.

EXHIBIT "G"
TO OPERATING AGREEMENT
TAX PARTNERSHIP AGREEMENTS

EXHIBIT "G"

TAX PARTNERSHIP AGREEMENTS

Industry has historically used oil and gas Tax Partnership Agreements where there is disproportionate sharing of expenses or to avoid Revenue Ruling 77-176.

I. Disproportionate Sharing of Expenses

The first situation involves a transaction where a party agrees to bear a disproportionate share of drilling expenses in exchange for a fractional interest in the property. In this situation, a question arises with regard to deduction of Intangible Drilling Costs (IDC) incurred in connection with the well. IRS Section 263 provides, in part, that a taxpayer can elect to capitalize or to deduct as expenses IDC in the case of oil and gas wells. Treasury regulations further provide that included in the option to expense or capitalize IDC are all IDC whether incurred by the Operator prior to or subsequent to the formal grant of an assignment to him of operating rights. In any case where any drilling or development project is undertaken for the grant or assignment of a fraction of the operating rights, then only that part of the costs which is attributable to the fractional interest is allowed under the option to be expensed or capitalized. In the excepted cases, costs of the project including depreciable equipment furnished, to the extent allocable to the fraction of the operating rights held by others, must be capitalized as the depletable costs of the fraction interest acquired.

II. Farmouts Subject to Revenue Ruling 77-176

The second major situation involves a Farmout subject to Revenue Ruling 77-176. Revenue Ruling 77-176 involved a Farmout where the drilling of a well by the Farmee earned the Farmee 100% of the Farmor's interest in the drilling unit (subject to an overriding royalty interest convertible to a working interest at payout), plus either the option to drill an additional well to earn additional acreage or an interest, less than 100% of the Farmor's interest, in certain acreage outside the drilling unit. Under Revenue Ruling 77-176, such a Farmout can have the following adverse tax consequences:

For Farmor - The Farmor is deemed to have "sold" the outside acreage to the Farmee. Thus, the Farmor is deemed to have received income from the sale, to the extent the fair market value of the outside acreage at the time of assignment exceeds the Farmor's basis in the outside acreage (usually the basis will consist of the lease bonus plus geological and geophysical costs). A similar situation would result with respect to the option a Farmee earns to drill additional wells and thereby earn additional acreage.

For Farmee - The Farmee is deemed to have received income equal to the fair market value of the outside acreage at the time of assignment, as additional compensation for drilling the Earning Well.

Interestingly, Revenue Ruling 77-176 has not been judicially tested.

Use of Tax Partnership

Tax Partnership has been employed to avoid adverse tax consequences in the above two situations because the parties' interests in the acreage are contributed to the partnership. The partnership then owns 100% of the operating interest in the contract premises and conducts the drilling of the wells. Since no party receives an interest in the acreage for undertaking the drilling of a well or wells, the adverse tax consequences detailed above are avoided.

Guidelines - There is no need to consider use of a Tax Partnership Agreement or an up-front assignment where:

- (1) only the drillsite is earned by a well, with the Farmee earning neither the option to earn additional drillsites nor an interest in outside acreage.
- (2) the Farmor retains neither a working interest nor an overriding royalty interest convertible to a working interest at payout in the drillsite acreage. (A Tax Partnership is not necessary, because the parties will never be joint working interest owners).

In spite of the burdens and complexities of the partnership form of operation, it has in recent years been utilized as a technique to avoid certain other adverse tax consequences. In particular, the use of partnerships with special allocation provisions is thought to avoid the problems of Revenue Ruling 77-176 (farmouts), and Revenue Ruling 80-109 (Multiple well payouts and IDC limitations in disproportionate spending situations.) Tax partnerships were thought to be either tax neutral or beneficial to the economics of the underlying transaction. However, new regulations recently promulgated under Code Section 704(b) individually and when coupled with Code Section 613A and recently enacted Code Section 704(c), have created significant turmoil and have suggested that the use of tax partnerships could in some situations adversely alter the anticipated underlying business economics of the transaction. As a consequence of this concern and the cost of creating and maintaining the tax partnerships, the continued use of the partnership merely to avoid IDC limitations and Revenue Rulings 77-176 and 80-109 is in doubt. See William M. Linden, Allocating Oil and Gas Partnership Tax Items Under the Final 704 (b) Regulations, 64 J. Tax'n 222 (1986).

Industry has continued to use tax partnerships while examining the alternatives. One alternative is to give up-front conditional assignments. An up-front conditional assignment would theoretically fix a low value (prediscovery of hydrocarbons) on the outside acreage or option acreage. The granting of an unconditional assignment would likely avoid the application of Revenue Ruling 77-176, but an assignment which

contains a condition (e.g. that the farmout terms be fulfilled) may not withstand challenge.

Because of the uncertainty of the interplay between Sections 613A and 704 and the concomitant impact on business community, industry is considering minimizing the use of tax partnership agreement. Although it is possible that the use of tax partnerships will be replaced with up-front conditional assignments, the API has undertaken to prepare a form to be attached to the JOA. A copy of the API Standard Tax Partnership Provision and an accompanying commentary are attached.

NOTE: This model has been prepared only as a suggested guide and may not contain all of the provisions that may be required by parties to an actual agreement. Use of the form or any variation thereof shall be at the sole discretion and risk of the user parties. Users of the model form or any portion or variation thereof are encouraged to seek the advice of counsel to ensure that their contract reflects the actual agreement of the parties.

EXHIBIT G
TAX PARTNERSHIP PROVISIONS
OF THE _____ TAX PARTNERSHIP
(fill in name)

1. Income Tax Compliance and Capital Accounts

The Operator shall prepare and file all required federal and state partnership income tax returns. In preparing such returns Operator shall use its best efforts and in doing so shall incur no liability to any other Party with regard to such returns. Not less than two weeks prior to the due date (including extensions) Operator shall submit to each Party a copy of the return as proposed for review.

The Operator shall establish and maintain fair market value ("FMV") capital accounts and tax basis capital accounts for each Party. Operator shall submit to each Party along with a copy of any proposed partnership income tax return an accounting of its respective capital accounts as of the end of the tax return period.

Each Party agrees to furnish to Operator not later than 30 days before the return due date (including extensions) such information relating to the operations conducted under this Agreement as may be required for the proper preparation of such returns and capital accounts.

2. Tax Matters Partner

2.1 Operator is Tax Matters Partner. Operator is designated tax matters partner ("TMP") as defined in Internal Revenue Code ("Code") §6231(a)(7). In the event of any change in Operator, the Party serving as TMP for a given taxable year shall continue as TMP with respect to all matters concerning such year. The TMP and other Parties shall use their best efforts to comply with responsibilities outlined in this section and in Code §§6222 through 6232 and 6050K (including any Treasury Regulations promulgated thereunder) and in doing so shall incur no liability to any other Party. Notwithstanding TMP's obligation to use its best efforts in the fulfillment of its responsibilities, TMP shall not be required to incur any expenses for the preparation for, or pursuance of administrative, or judicial proceedings, unless the Parties agree on a method for sharing such expenses.

2.2 Information Request by TMP. The Parties shall furnish TMP within two weeks from the receipt of the request with such information (including information specified in Code §§6230(e) and 6050K) as TMP may reasonably request to permit it to provide the Internal Revenue Service with sufficient information for purposes of Code §§6223 and 6050K.

2.3 TMP Agreements with IRS. The TMP shall not agree to any extension of the statute of limitations for making assessments on behalf of any other Party without first obtaining the written consent of that Party. The TMP shall not bind any other Party to a settlement agreement in tax audits without obtaining the concurrence of any such Party.

Any other Party who enters into a settlement agreement with the Secretary of the Treasury with respect to any partnership items, as defined by Code §6231(a)(3), shall notify the other Parties of such settlement agreement and its terms within 90 days from the date of settlement.

2.4 Inconsistent Treatment of Partnership Item. If any Party intends to file a notice of inconsistent treatment under Code §6222(b), such Party shall, prior to the filing of such notice, notify the TMP of such intent and the manner in which the Party's intended treatment of a partnership item is (or may be) inconsistent with the treatment of that item by the partnership. Within one week of receipt the TMP shall remit copies of such notification to other Parties to the Partnership. If an inconsistency notice is filed solely because of a Party not having received a Schedule K-1 in time for filing of its income tax return, the TMP need not be notified.

2.5 Requests for Administrative Adjustment. No Party shall file a request pursuant to Code §6227 for an administrative adjustment of partnership items for any Partnership taxable year without first notifying all other Parties. If all other Parties agree with the requested adjustment, the TMP shall file the request for administrative adjustment on behalf of the Partnership. If unanimous consent is not obtained within 30 days from such notice, or within the period required to timely file the request for administrative adjustment, if shorter, any Party, including the TMP, may file a request for administrative adjustment on its own behalf.

2.6 Judicial Proceedings. Any Party intending to file a petition under Code §§6226, 6228, or any other Code section with respect to any partnership item, or other tax matters involving the Partnership, shall notify the other Parties of such intention and the nature of the contemplated proceeding. In the case where the TMP is the Party intending to file such petition, such notice shall be given within a reasonable time to allow the other Parties to participate in the choosing of the forum in which such petition will be filed. If the Parties do not agree on the appropriate forum, then the appropriate forum shall be decided by majority vote. Each Party shall have a vote in accordance with its percentage interest in the Partnership for the year under audit. If a majority cannot agree, the TMP shall choose the forum. If a Party intends to seek review of any court decision rendered as a result of such a proceeding such Party shall notify the other Parties.

2.7 Windfall Profit Tax. The Parties agree to take appropriate action under Code §6232(c) and any Treasury Regulations thereunder to assure that items required to compute the Windfall Profit Tax as imposed by Chapter 45 of the Code not be treated as partnership items.

3. Elections

3.1 General Elections. For both income tax return and capital account purposes, the Partnership shall elect (a) to deduct currently intangible drilling and development costs ("IDC"), (b) to use the maximum allowable accelerated tax method and the shortest permissible tax life for depreciation purposes, (c) to use the accrual method of accounting, and (d) to report income on a calendar year basis.

(e) If checked below:

dispositions of depreciable assets shall be accounted for under the Mass Asset method to the extent permitted by Code §168(d)(2)(A). (Check if applicable.)

3.2 Depletion. Solely for FMV capital account purposes, depletion shall be calculated by using simulated percentage _____ depletion within the meaning of Treasury Regulation §1.704-1(b)(2)(iv)(k)(2). (If desired strike "percentage" and write in "cost".)

3.3 Other Elections. Any other elections must be approved by the affirmative vote of two (2) or more Parties owning a majority interest based on the post payout ownership as shown in Exhibit "A".

4. Capital Contributions and FMV Capital Accounts

4.1 Capital Contributions. The respective capital contributions of each Party to the Partnership shall be (a) each Party's interest in the oil and gas lease committed to this Partnership, and all properties associated with the lease, and (b) all amounts paid by each Party in connection with the acquisition, exploration, development and operation of the lease, and all other costs characterized as contributions or expenses borne by such Party under this Partnership. The contribution of the leases and any other properties committed to this Partnership shall be made by each Party's agreement to hold legal title to its interest in such leases or any other properties as nominee for this Partnership.

4.2 FMV Capital Accounts. The FMV capital accounts shall be increased and decreased as follows:

(a) The FMV capital accounts shall be increased by: (i) the amount of money and the fair market value of any property contributed by each Party, respectively, to the Partnership (net of liabilities assumed by the Partnership or to which the contributed property is subject); (ii) that Party's Sec. 5.1 allocated share of Partnership income and gains, or items thereof; (iii) any basis increases required by Code §§48(q) and 1016(a)(24); and, (iv) that Party's share of Code §705(a)(1)(B) and (C) items.

(b) The FMV capital accounts shall be decreased by: (i) the amount of money and the fair market value of property distributed to each Party (net of liabilities assumed by such Party or to which the property is subject); (ii) that Party's Sec. 5.1 allocated share of Partnership loss and deductions, or items thereof; (iii) any basis decreases required by Code §§48(q) and 1016(a)(24); and, (iv) that Party's share of Code §705(a)(2)(B) items and Code §709 nondeductible and nonamortizable items.

"Fair market value" when it applies to property contributed by a Party to the Partnership shall be assumed to equal the adjusted basis, as defined in Code §1011, of that property unless the Parties agree otherwise as indicated below or in a separate written agreement.

Property Contributed	Agreed Fair Market Value
_____	_____
_____	_____
_____	_____

5. Partnership Allocations

5.1 FMV Capital Account Allocations. Each item of income, gain, loss or deduction shall be allocated to each Party as follows:

- (a) Actual or deemed income from the sale, exchange, distribution or other disposition of production shall be allocated to the Party entitled to such production or the proceeds from the sale of such production. In the event that deemed income arising from the in-kind distribution of production equals the fair market value of the production distributed to a Party, the Parties recognize that the corresponding adjustments would be a net zero adjustment and, accordingly, may be omitted from the FMV capital accounts;
- (b) Exploration cost, IDC, operating and maintenance cost shall be allocated to each Party in accordance with its respective contribution to such cost;
- (c) Depreciation shall be allocated to each Party in accordance with its contribution to the FMV capital account adjusted basis of the underlying asset;
- (d) Simulated depletion shall be allocated to each Party in accordance with its FMV capital account adjusted basis in each oil and gas property;
- (e) Loss (or simulated loss) upon the sale, exchange, distribution, abandonment or other disposition of depreciable or depletable property, shall be allocated to the Parties in the ratio of their respective FMV capital account adjusted basis in the depreciable or depletable property;
- (f) Gain (or simulated gain) upon the sale, exchange, distribution, or other disposition of depreciable or depletable property shall be allocated to the Parties so that the FMV capital account balances of the Parties with respect to such property will most closely reflect their respective percentage or fractional interests under the Agreement;
- (g) Costs or expenses of any other kind shall be allocated to and accounted for by each Party in accordance with its respective contribution to such costs or expenses; and,
- (h) Any other income item shall be allocated to the Parties in accordance with the allocation of the realization.

5.2 Tax Returns and Tax Basis Capital Account Allocations

- (a) Unless otherwise expressly provided herein the allocations of Partnership items of income, gain, loss or deduction for tax return and tax basis capital account purposes shall be the same as those contained in Sec. 5.1;
- (b) The Parties recognize that under Code §613A(c)(7)(D), the depletion allowance is to be computed separately by each Party. For this purpose, each Party's share of the adjusted tax basis of each oil and gas property shall be equal to its contribution to the adjusted tax basis of such property;
- (c) The Parties recognize that under Code §613A(c)(7)(D) the computation of gain or loss on the taxable disposition of an oil or gas property is to be computed separately by each Party. For this purpose the portion of the total amount realized by the Partnership that represents a recovery of simulated adjusted basis in an oil and gas property will be allocated to the Parties in the same ratio that simulated depletion is allocated to them under Sec. 5.1(d). Any additional amount realized will be allocated in accordance with the ratio of simulated gain allocation for such property under Sec. 5.1(f);
- (d) Depreciation shall be allocated to each Party in accordance with its contribution to the adjusted tax basis of the depreciable asset;
- (e) Any recapture of depreciation, IDC, and any other item of deduction or credit shall, to the extent possible, be allocated among the Parties in accordance with their sharing of the depreciation, IDC or other item of deduction or credit which is recaptured;
- (f) The qualified investment for investment tax credit purposes with respect to any property shall be allocated among the Parties in accordance with their respective contributions to the qualified investment (as defined in the Code) in such property;
- (g) For Partnership property which has a value in the FMV capital accounts which differs from the adjusted tax basis of such property, any tax items relating to such property will be allocated to the Parties in a manner which takes into account the variation between the adjusted tax basis of such property and its FMV capital account value under Code §704(c); and,
- (h) Unless checked below, the income attributable to take-in-kind production will not be reflected

on the tax return.

___ The provision for taking production in-kind, as provided elsewhere in this Agreement, is recognized as each Party's right to determine the market for a proportionate share of the production. All items of income, deductions, and credits arising from such marketing of production shall be recognized by the Partnership and shall be allocated respectively to the Party who designated such market.

6. Distribution Upon Termination

6.1 *Termination*. Termination shall occur on the earlier of the termination of the Partnership under Code §708(b)(1) or the date upon which the Partnership ceases to be a going concern. Upon termination the business shall be wound-up and concluded, and the assets shall be distributed to the Parties as described below by the end of such calendar year (or, if later, within 90 days after the date of such termination). All assets shall be distributed to the Parties as provided in Sec. 6.2 through 6.4.

6.2 *Reversion*. First, all money representing unexpended contributions by any Party and any property where no interest has been earned in that property under the agreement by any other Party shall be returned to the contributor.

6.3 *Balancing*. Second, the FMV capital accounts of the Parties shall be determined under this Sec. 6.3. The Operator shall take the actions specified under this Sec. 6.3 in order to cause the ratio of the Parties' FMV capital accounts to reflect as closely as possible their percentage interests under the Agreement. The ratio of a Party's FMV capital account is represented by a fraction, the numerator of which is the Party's FMV capital account balance and the denominator of which is the sum of all Parties' FMV capital account balances. Such actions are hereafter referred to as "balancing the FMV capital accounts," and when completed, the FMV capital accounts of the Parties shall be referred to as being "balanced." The manner in which the FMV capital accounts of the Parties are to be balanced under this Sec. 6.3 shall be determined as follows:

- (a) The fair market value of all Partnership properties shall be determined and the gain or loss for each property which would have resulted if a sale thereof at such fair market value had occurred shall be allocated in accordance with Sec. 5.1(e) and (f). If thereafter any Party has a negative FMV capital account balance, that is, a balance less than zero, such Party shall contribute an amount of money to the Partnership sufficient to achieve a zero balance FMV capital account. Any Party may contribute an amount of money to the Partnership to facilitate the balancing of the FMV capital accounts. If FMV capital accounts are not balanced, Sec. 6.3(b) or (c) shall apply;
- (b) If all the Parties consent, any money or an undivided interest in certain selected properties shall be distributed to one or more Parties as necessary for the purpose of balancing the FMV capital accounts;
- (c) Unless (b) above applies, an undivided interest in each and every property shall be distributed to one or more Parties in accordance with the ratios of their FMV capital accounts;
- (d) If a property is to be valued under (a) above or distributed pursuant to (b) or (c) above, the fair market value of the property shall be agreed to by the Parties. In the event all of the Parties do not reach agreement as to the fair market value of property, the Operator shall cause a nationally recognized independent engineering firm to prepare an evaluation of fair market value of such property.

6.4 *Final Distribution*. Third, after the FMV capital accounts of the Parties have been adjusted, pursuant to Sec. 6.3 above, all other or remaining property and interest then held by the Partnership shall be distributed to the Parties in accordance with their FMV capital account balances.

7. Transfers, Survivorship and Correspondence

7.1 *Transfers*

- (a) These Partnership provisions shall inure to the benefit of and be binding upon the Parties hereto and their successors and assigns. The Parties agree that if any one of them makes a sale or assignment of its interest under this Agreement, such sale or assignment will be structured, if possible, so as not to cause a termination under Code §708(b)(1)(B).

[Note: The following provisions of Sec. 7.1(b) and 7.1(c) are additional, more stringent limitations on a Party's ability to transfer its interest. Either or both of these provisions should be deleted if unwarranted.]

- (b) No Party may assign its interest or any portion thereof under this Agreement without the written consent of the other Parties. (Strike if inapplicable.)
- (c) If a Code §708(b)(1)(B) termination is caused, the terminating Party will indemnify the nonterminating Parties and save them harmless for any increase in taxes, interest, and

penalties or decrease in credits caused by the termination of the Partnership. The indemnification, if any, shall be computed on a cash flow basis taking into consideration the liability for tax on any indemnification proceeds received by the nonterminating Parties. (Strike if inapplicable.)

7.2 Survivorship. Any termination of the Agreement shall not affect the continuing application of the tax Partnership provisions as necessary for the termination and liquidation of the tax Partnership.

7.3 Correspondence. All correspondence relating to the preparation and filing of the Partnership's income tax returns and capital accounts shall be forwarded to:

COMMENTARY

AMERICAN PETROLEUM INSTITUTE TAX PARTNERSHIP PROVISIONS

INTRODUCTION.

The purpose of this commentary is to describe the attached "Exhibit G Tax Partnership Provisions." These provisions were drafted to be an exhibit to the A.A.P.L. Form 610-1982 Model Form Operating Agreement. (Hereinafter for convenience the "Exhibit G Tax Partnership Provisions" will be referred to as the "Tax Provisions" and the A.A.P.L. Form 610-1982 Model Form Operating Agreement will be referred to as the "Model Operating Agreement" or "MOA.")

The remainder of this commentary is divided into the following three components:

1. Instructions.
2. General Overview.
3. Section-by-Section Analysis.

INSTRUCTIONS.

Model Operating Agreement. When the Tax Provisions are used with the Model Operating Agreement, the following changes should be made to the latter agreement:

1. Exhibit "G". The Tax Provisions should be attached as Exhibit "G" to the MOA. Identification of this exhibit should be made in Article II of the MOA. In the case of any conflict between Exhibit "G" and the MOA, the provisions of Exhibit "G" will take precedence.
2. Article IX. The existing Article IX, Internal Revenue Code Election of the MOA should be deleted. In lieu thereof a specific cross-reference to the Tax Provisions should be made.
3. Exhibit "A". Exhibit "A" of the MOA should be reviewed to ensure that the post-payout or fractional interests of the parties are specified.

Drilling Agreement. If the MOA is attached as an exhibit to a letter agreement documenting a farmout, farmin, area of mutual interest, or similar agreement (hereinafter collectively referred to as the "Drilling Agreement"), then the Drilling Agreement should contain a specific reference to the Tax Provisions. This reference should provide:

1. That the parties recognize that the contractual arrangement and undertakings evidenced by the Drilling Agreement result in a partnership for federal income tax purposes and for purposes of state income tax law which adopt or follow federal income tax principles as to partnerships.
2. That for these income tax purposes the parties agree to be bound by the Tax Provisions.
3. That the Tax Provisions will be effective as of the effective date of the Drilling Agreement, notwithstanding that the MOA may not become effective until some later time.
4. That in the event of any conflict or inconsistency between the terms of the Tax Provisions and the terms of the Drilling Agreement (or any exhibit thereto other than the Tax Provisions), that the terms of the Tax Provisions will control.

The reasons for subparagraphs 1-3 above are to evidence the parties' intent to be a partnership for tax purposes and to establish that the partnership is effective as of the effective date of the Drilling Agreement. This latter point is important because it is often the Drilling Agreement that gives rise to the tax concerns which result in the use of tax partnership provisions.

The reason for subparagraph 4 above is that in order to sustain for tax purposes the "special allocations" of items of income, gain, loss, deduction, and credit (for example, IDC deductions) provided for in the Tax Provisions, it is necessary that those provisions take precedence over any conflicting provisions. The circumstance in which this can be the most critical is if the Tax Provisions mandate a distribution of partnership property upon the termination of the partnership that is different than the distribution provided for in the Drilling Agreement. As will be discussed in the example described in Section 6, it is possible that the Tax Provisions will mandate a different distribution of property than the Drilling Agreement.

GENERAL OVERVIEW.

The Tax Provisions were designed to maintain, to the extent possible under the confines of currently applicable Internal Revenue Code ("Code") and regulatory provisions, the "traditional economics" of a Drilling Agreement involving tax concerns raised by "outside acreage" earning provisions or by IDC-payout rules. The term "traditional economics" is intended to mean that the tax attributes generated by the partnership will be shared by the parties in the same manner as the tax attributes would have been "shared" if partnership provisions had not been used. This approach requires that "functional allocations" or "strict tracing" be used whereby particular partnership tax attributes are allocated to reflect the particular contributions made by a party to the partnership. For example, if a party contributes the oil and gas lease to the partnership, then the tax attributes generated by that lease (*i.e.*, depletion or abandonment loss deductions) will be allocated to that party, provided, of course, that this allocation can be made in accordance with taxation principles.

The limitations imposed by the Code and regulatory provisions on the ability to use "functional allocations" is best illustrated by the Drilling Agreement commonly referred to as a "drill to earn" deal. As discussed in Section 6, in this situation when a dry hole is drilled and the partnership is terminated, the use of "functional allocations" may require that the interests in the oil and gas lease be distributed in a manner that does not reflect the "drill to earn" nature of the deal.

In addition to recognizing that the use of tax partnership provisions with a Drilling Agreement may change the "traditional economics" of the deal, it should also be recognized that the utilization of tax partnership provisions will (i) require the application of a very complex body of tax law, and (ii) entail the imposition of substantial additional accounting requirements. Before using any tax partnership provisions, including the Tax Provisions, careful consideration should be given to the alternative of electing out of Subchapter K of the Code and possibly incurring some additional tax costs in order to avoid the substantial burdens inherent in tax partnerships.

SECTION 1: INCOME TAX COMPLIANCE AND CAPITAL ACCOUNTS.

Operator's Duties. Operator agrees to (i) prepare and file all required federal and state partnership income tax returns, and (ii) establish and maintain the fair market value and tax basis capital accounts for the parties. Operator will provide copies of the proposed income tax returns to the other parties prior to the filing of the returns.

Capital Accounts. Two sets of capital accounts must be established and maintained. The first is the fair market value

("FMV") capital accounts necessitated by the regulations under Code §704(b) in order to establish the "substantial economic effect" of the "special allocations" provided for in the Tax Provisions. These capital accounts will also be necessary in order to comply with Code §704(c), if the contribution of appreciated/depreciated property to the partnership causes the application of this Code section. Accounting for these FMV capital accounts is provided for in Sections 4 and 5.1.

The second set of capital accounts is the tax basis capital accounts that are necessary in order to account for the tax attributes of the partnership. These capital accounts will account for the information that is reported on the partnership income tax return and the individual party's returns. Accounting for these tax basis capital accounts is provided for in Section 5.2.

Non-Operator's Duties. Each party is required to furnish any information required by Operator in preparing the partnership income tax returns and capital accounts. Such information may include, but is not limited to, the adjusted tax basis of property contributed to the partnership, information on the value of any oil and gas produced (whether or not taken in kind), and information on the transfer of partnership interests.

SECTION 2: TAX MATTERS PARTNER.

Overview. Code §§6222 - 6232 allow the Internal Revenue Service ("IRS") to audit "partnership items" (as defined in Code §6231(a)(3)) at the partnership level rather than at the individual partner level. These Code sections also provide for the designation of one of the partners (i.e., the "tax matters partner" or "TMP") to represent the partnership in administrative and judicial proceedings. This Section 2 is intended to define (and in some cases restrict) the role of the TMP in the event of a partnership audit and to provide for the participation of the non-TMP parties.

Section 2.1. Operator is designated as TMP. As TMP, the Operator is responsible for (i) keeping the IRS informed of the parties' identification data, (ii) filing "requests for administrative adjustments" (see Code §6227), and (iii) keeping the non-TMP parties informed with respect to administrative and judicial proceedings. It should be noted that the last sentence of this provision may impose a limit on the TMP's expense incurring authority that is different than the Operator's expense incurring authority under the Model Operating Agreement.

Section 2.2. This provision is a corollary to the non-TMP parties' obligations under Section 1 to provide the TMP with necessary information.

Section 2.3. Under Code §§6224 and 6229, a TMP has the authority to enter into agreements with the IRS as to extending the statute of limitations and to the settling of controversies. This Section 2.3 limits the authority of the TMP to enter into these agreements. In addition, if a non-TMP party enters into a settlement agreement as to a partnership item with the IRS, such party is obligated to notify the other parties.

Section 2.4. Under Code §6222(b), a partner must file a "notice of inconsistent treatment" with the IRS if that partner is reporting an item on its individual return in a manner that is inconsistent with the treatment of that item on the partnership's income tax return. However, inconsistencies relating solely to accrual differences do not require such notification. Because such a notice may trigger a partnership level audit, it is important that all the parties to the MOA or Drilling Agreement are informed of one party's action. Accordingly, this Section 2.4 provides a notice requirement.

Section 2.5. This section limits the ability of the TMP to file a "request for administrative adjustment" on behalf of the partnership. Any such request can be filed only if all the parties agree. If a "request for administrative adjustment" is filed on behalf of the partnership, then the TMP must be aware that only the TMP may file a "petition for adjustment" with a court if the IRS fails to act on the request.

Section 2.6. This section is intended to provide for coordination of any judicial proceedings by the parties. It also curtails the broad statutory authority of the TMP to select the forum for the judicial review of any partnership adjustments. If a majority of the parties cannot agree as to the appropriate forum, only then will the TMP be able to select the forum. Any party's statutory right to appeal the decision of a trial court is not affected by this provision, aside from a notification requirement.

Section 2.7. Code §6232 allows a partnership to act for its partners with respect to certain Windfall Profit Tax ("WPT") matters, absent a determination by the partners that the partnership is not to act. This Section 2.7 evidences the parties' intent that the partnership not act for the parties with respect to these WPT matters.

SECTION 3: TAX RETURN AND CAPITAL ACCOUNT ELECTIONS.

Section 3.1. For both income tax return and capital account purposes the following elections are made: (i) to expense currently IDC, (ii) to depreciate property in the most accelerated manner, (iii) to use the accrual method of accounting, and (iv) to use the calendar year as the partnership's taxable year.

In addition, provision is made for the parties to affirmatively elect to use the Mass Asset method of accounting for depreciable property dispositions. In general, under the Mass Asset method (i) the gain on the disposition is equal to the sales proceeds without reduction for any remaining undepreciated tax basis and (ii) the depreciation deductions for the disposed of asset continue to be claimed as if the disposition never occurred. The reason for electing the Mass Asset method is that it can simplify the accounting for asset dispositions because gain/loss calculations are not required and because any potential "ceiling rule" problems under Treasury Regulation section 1.704-1(c)(2) are avoided.

Section 3.2. For FMV capital account purposes, simulated percentage depletion is elected because it avoids the necessity of the parties exchanging reserve estimates. In addition, it should also provide a more rapid recovery of depletable basis and, therefore, more quickly eliminate any FMV capital account "out of balances" attributable to depletable properties. If the parties desire, however, simulated cost depletion can be elected.

Section 3.3. Any other elections are required to be made by an affirmative, majority vote of two or more parties.

SECTION 4: CAPITAL CONTRIBUTIONS AND FMV CAPITAL ACCOUNTS.

Overview. The purpose of this Section 4 is to set forth the terms under which the parties' FMV capital accounts are to be established and maintained. These FMV capital accounts are intended to demonstrate that the "special allocations" provided for in the Tax Provisions satisfy the "substantial economic effect" test of Code §704(b) and Treasury Regulation §1.704-1(b). Briefly stated, this test requires that FMV capital accounts be established and maintained (see this Section 4) and that upon termination (i) the partnership's assets be distributed in accordance with capital account balances and (ii) any negative capital account balances be restored (see Section 6).

Section 4.1. The purpose of this provision is to identify each party's contribution to the partnership. In general terms, these contributions include (i) the interest of each party in the oil and gas leases and associated properties made subject to the partnership and (ii) the expenditures made by each party in furtherance of the exploration, development, etc. activities of the partnership. The contribution of any oil and gas leases to the partnership does not require the cross-assignment of leases between the parties. Rather, as the last sentence of this provision indicates, the contribution may be effected by each party holding title as nominee for the partnership.

Section 4.2. In general terms, the FMV capital accounts are (i) increased by contributions of money and property and by partnership allocations of income and gain and (ii) decreased by distributions of money and property and by partnership allocations of losses and deductions.

The parties' agreement as to the fair market value of the contributed property can be set forth in this provision. The establishment of the fair market value of any contributed property is a key factor in that such value, as reflected in the FMV capital accounts, will greatly influence both the partnership allocations that can be made and the share of partnership property that a party will receive upon termination of the partnership. However, absent an express determination by the parties' agreement, the adjusted tax basis of any contributed property will be deemed to equal its fair market value. Although the ascertainment of the fair market value of property is often difficult, particularly with respect to oil and gas leases, the terms of Treasury Regulation §1.704-1(b) necessitate it.

SECTION 5: PARTNERSHIP ALLOCATIONS.

Section 5.1. The purpose of this provision is to specify the adjustments to be made to the FMV capital accounts in order to establish "substantial economic effect." These adjustments are, however, also generally the same as the allocations of partnership tax attributes for tax purposes (see Section 5.2(a)).

- (a). Income from the sale of production, whether or not taken in kind, is allocated to the party entitled thereto. The provision reflects the uncertainty as to whether it is necessary to reflect any adjustments for production income in the FMV capital accounts if there are offsetting debits and credits. It is recognized that the "inclusion" of production income in the "partnership" may be a departure from the general historical practice where the parties have taken production in kind. However, the "inclusion" of the production income may have become necessary as a result of Treasury Regulation §1.704-1(b).
- (b). Deductions for IDC, exploration costs, and operating and maintenance costs, are allocated to the party contributing the cash used to pay such costs.
- (c). Depreciation deductions are allocated to the party contributing the property giving rise to the depreciation. If cash contributed to the partnership is used to acquire depreciable property, then the party contributing the cash is deemed to have contributed the property and the depreciation deductions attributable to that property will be allocated to the cash-contributing party in accordance with the FMV capital account basis of the acquired property.

(d). Simulated depletion is allocated to each party that contributed to the depletable basis of the oil and gas lease. As provided for in Section 3 and as discussed in the comments thereto, simulated percentage depletion is to be utilized absent an affirmative election to the contrary.

(e). Any loss (including a simulated loss) upon the sale or other disposition of property is to be allocated to the parties in accordance with their respective contributions to the basis of the property.

(f). Any gain (including a simulated gain) upon the sale or other disposition of property is to be allocated in a manner that will result in the balancing of capital accounts. This provision is intended to provide a means to balance the capital accounts in accordance with the parties' respective interests under the MOA or Drilling Agreement.

(g). This is a miscellaneous, "catch-all" provision that allocates any non-specified items in accordance with the parties' respective contributions thereto.

Section 5.2. The purpose of this provision is to identify the partnership tax attributes that are to be allocated to each party as such party's respective Code §704(b) distributive share. The purpose of the tax basis capital accounts is to account for these distributive shares.

(a). The general rule is that the allocations made under Section 5.1 for purposes of the capital accounts are also to be made in determining the parties' respective distributive shares, unless a specific provision provides to the contrary.

(b). Pursuant to Code §613A(c)(7)(D), depletion is to be computed separately by each party based on its depletable basis in any oil and gas property contributed to the partnership.

(c). Pursuant to Code §613A(c)(7)(D), the calculation of gain and loss on the disposition of an oil and gas property is to be done separately by each party. Pursuant to Treasury Regulation §1.704-1(b)(4)(v), the amount realized -- up to the amount of the remaining simulated basis in the property -- is to be specially allocated to the parties that have previously been allocated depletable basis.

(d). Depreciation is to be allocated to the party that contributed the property or that contributed the cash that was used to acquire the property.

(e). Any recapture is to be allocated -- to the extent possible -- to the parties who received the benefit of the deduction/credit that gave rise to recapture obligation.

- (f). For purposes of allocating ITC, qualified investment is to be allocated to the party that contributed the property or that contributed the cash to acquire the property.
- (g). This provision recognizes the mandatory application of Code §704(c) with respect to the contribution of appreciated/depreciated property to the partnership.
- (h). In the absence of a contrary election, this provision would operate to exclude from the partnership income tax return any production income attributable to production taken in kind. This is consistent with the historic practice in the industry.

SECTION 6: DISTRIBUTION UPON TERMINATION.

Overview. This provision provides the procedure for distributing the assets of the partnership to the parties in accordance with the parties' respective capital account balances upon termination of the partnership. The procedure may result in the alteration of the business deal, particularly in a drill to earn arrangement.

Section 6.1. Termination of the partnership will be effected upon the occurrence of a specified event. Upon termination the partnership's business will be wound-up and the partnership's assets will be distributed.

Section 6.2. Unexpended cash contributions and property in which no other party has earned an interest are distributed to the contributing party.

Section 6.3. FMV capital accounts are to be "balanced" by:

- (a). "Deemed sales" of partnership property and by "voluntary" cash contributions by a party whose capital account has a lower balance than that necessary to distribute the partnership assets in the desired manner. In addition, if any party has a negative capital account balance, that party is required to restore the deficit amount (i.e., bring the capital account balance to zero) by a contribution of cash. The inclusion of this latter provision is required under Treasury Regulation §1.704-1(b) in order to establish economic effect.
- (b). "Selective" distributions of money or property, provided all the parties consent to such distributions.
- (c). "Mandatory" distributions of undivided interests in property.

(d). The parties are to agree as to the fair market value of distributed property for purposes of the capital account adjustments. If the parties cannot so agree, then an independent engineering firm will be retained to appraise the property.

Section 6.4. After the FMV capital accounts are adjusted in accordance with Section 6.3, then the remaining partnership property, if any, will be distributed in accordance with the parties' respective capital account balances.

Discussion. Given the provisions of Code §704(c) and Treasury Regulation §1.704-1(b), there can be no assurance that upon termination of a partnership any remaining partnership property will be distributed to the parties in accordance with their respective interests in the underlying MOA or Drilling Agreement. The foregoing "balancing" provisions were intended to be a flexible means of adjusting capital accounts in ways that result in the least possible alteration of the underlying business arrangement between the parties. This is particularly true of the "voluntary" cash contributions provided for in Section 6.3(a). Similarly, the gain allocation provision of Section 5.1(f) is another tool that allows flexible adjustments to FMV capital accounts, particularly with respect to "deemed sales."

Example. The foregoing can be exemplified most clearly in the following drill to earn deal.

1. Party "A" contributes the 160-acre lease on which the well is to be drilled. Party "A" owns a 100% working interest in this lease and it has a tax basis in this lease of \$16,000 (\$100 per acre).

2. Party "B" agrees to contribute the cash to drill the well on the lease. The dry-hole costs of this well are expected to equal \$100,000. If the well is completed, then the completion costs will total another \$25,000.

3. If the well is a dry hole, the deal will terminate and Party "B" will be assigned a 50% interest in the entire 160-acre lease. If the well is productive, Party "B" will be assigned (i) a 100% interest in the drillsite spacing unit for the well, subject to Party "A's" retention of an overriding royalty convertible at payout to a 50% working interest, and (ii) a 50% interest in the non-drillsite portion of the lease.

4. The parties elect to use partnership provisions that provide for "functional allocations." That is, Party "A" will be allocated any depletion deductions attributable to the lease and Party "B" will be assigned any IDC/depreciation deductions attributable to the drilling of the well.

5. Assuming the "value" of Party "A's" leasehold equals its tax basis, then the respective capital accounts of the parties up to the casing point of the well are as follows:

	<u>Party "A"</u>	Party "B"
Contribution	\$ 16.0 M	\$100.0 M
Deductions	<u>—</u>	<u>(100.0 M)</u>
	\$ 16.0 M	—

Example - Analysis. If the well were dry, then only Party "A" would have a positive capital account balance and, accordingly, would be entitled to receive the entire interest in the lease notwithstanding that the Drilling Agreement provided that Party "B" was entitled to a 50% interest in the lease. Under the "balancing" provisions of Section 6.3, any loss upon the "deemed sale" of the oil and gas lease would be allocated to Party "A". Suppose, for example, that the value of the lease after the drilling of the dry hole was \$5M. Thus, the "loss" upon the deemed sale of the lease would equal \$11M (i.e., \$5M "amount realized" minus \$16M basis). This loss would be allocated to Party "A" pursuant to Section 5.1(e), thereby reducing Party "A's" capital account balance to \$5M. Party "A" would still be entitled to a distribution of a 100% interest in the lease at this point unless Party "B" wanted to make a "voluntary" cash contribution of \$2.5M in order to obtain a 50% interest in the lease. The \$2.5M cash contribution would: (i) increase Party "B's" capital account balance to \$2.5M; (ii) be distributed to Party "A", thereby reducing Party "A's" capital account balance to \$2.5M; and (iii) allow the oil and gas lease to be distributed to the parties 50/50 because the parties' respective capital accounts were equal. Absent such a contribution, Party "A" would receive the entire lease.

Obviously, the foregoing changes the nature of the underlying business deal. The same could be true even if a productive well were drilled if the partnership were terminated prior to the time when the parties' capital accounts were in balance or could be balanced pursuant to the "deemed sale" provision.

SECTION 7: TRANSFERS AND CORRESPONDENCE.

Section 7.1. This provision addresses the parties' respective rights and obligations in the event one party transfers its interest in the partnership.

- (a). If a party's transfer of its partnership interest would cause a termination of the partnership under Code §708, then that party obligates itself to attempt to structure the transfer in a manner so as not to cause the partnership termination. Under Code §708, a sale or exchange of a 50% or more interest in partnership capital

and profits within a 12-month period will cause a termination of the partnership for tax purposes. Such a termination may cause tax problems for the continuing partners, including extending the depreciable lives of partnership properties (for e.g., ADR property), switching tax bases amounts among the various partnership assets, and causing the recapture of ITC. In addition, premature termination of the partnership can cause problems if the capital accounts are not susceptible to being balanced solely with partnership assets at the time of termination.

Thus, it is important that the parties are fully aware of the tax consequences of any transfer of a partnership interest and that any transfer be structured, if possible, so as to avoid any disadvantageous tax consequences resulting from a partnership termination.

[Note: As noted in the Tax Provisions, Sections 7.1(b) and 7.1(c) provide additional, more stringent limitations on the ability of a party to transfer its interest. These provisions were specifically highlighted because there is no consensus so as to their appropriateness. It should be anticipated that some API members will choose not to use these provisions.]

(b). This provision has two purposes in addition to those set forth in Section 7.1(a). Firstly, as an additional, more stringent limitation on a party's ability to transfer its interest, one purpose is to avoid any unintended termination of the partnership. By requiring the written consent of the parties to a transfer, the parties should be fully aware of the tax consequences of the transfer. Secondly, by limiting the free transferability of interests, this provision will assist in the classification of the arrangement as a partnership rather than as an "association taxable as a corporation."

(c). This provision is included as a means to "enforce" the terms of Sections 7.1(a) and (b). The underlying premise of the provision is that because the sale or exchange of a partnership interest is, in general, a volitional act, an indemnification is warranted in order to provide a remedy for a party's failing to abide by the terms of Sections 7.1(a) and 7.1(b).

Under the indemnification provision, if a party terminated the partnership by transferring its interest, then such party would be required to indemnify the other parties for any additional tax "burdens" that resulted from the termination. As demonstrated below, the term tax "burdens" includes more than just additional overall tax liability, but also such things as a deferral in the ability to claim deductions (as, for example, would occur if a partnership termination caused the extension of the lives of depreciable

property). This indemnification would be computed on a present value basis and would take into account any tax liability the nonterminating parties would incur on the receipt of the indemnification proceeds (i.e., the indemnification proceeds would be grossed-up).

For example, if a partnership deduction of \$100 allocated to a nonterminating party was delayed one year because of the partnership's Code §708 termination and the present value of the deduction was reduced by \$8.10 because of the delay, then it is intended that the indemnification amount would be calculated by grossing-up this amount. If the nonterminating party were in the 46% tax bracket, then it is intended that the indemnification amount would equal \$15, calculated by $\$8.10 / (1 - .46)$. For this purpose, it is also intended that the nonterminating party's tax bracket be determined from its financial reports.

Section 7.2. This section makes clear that the applicability of the Tax Provisions is not determined by the life of the MOA.

Section 7.3. This section is intended to be used to show the appropriate mailing addresses to which partnership information is to be sent.

PROBLEMS ON OPERATING AGREEMENTS

All the problems assume that the parties have executed an A.A.P.L. 610 - 1982 Model Form Operating Agreement.

Problem 1

Dry Hole Corporation, as Operator, drills a well which does not encounter oil or gas, but which does encounter significant quantities of carbon dioxide. Secondary Recovery Ltd. wishes to use the JOA to jointly develop the carbon dioxide.

Does the JOA apply?

Problem 2

A JOA is entered into by X, as Operator, and Y and Z. Exhibit "A" designates the parties' interests as follows:

X	60%
Y	30%
Z	10%

The parties successfully complete a well which is located on an 80 acre drilling unit. The entire drillsite is located on a single lease which is owned 70% by X and 30% by Y.

How is production owned?

How should royalties be charged?

- A. "one-eighth (1/8th)" is inserted in the blank on line 15, page 2.
 - The lease contributed by Z contains a 3/8th royalty.
- B. "one-quarter (1/4)" is inserted in the blank on line 15, page 2.
 - The lease contributed by Z contains a 3/8th royalty.

Problem 3

On December 15, 1985 Sun and Arco spud a deep well, pursuant to a JOA. Each party has a 50% interest. Four days before the well reached total depth, Arco lost litigation which awarded its lease to Wise Oil Company. The well cost a total of \$10MM. The last four days cost \$30,000. The well is dry.

Is Arco responsible for the entire cost of the well? If not, for how much?

Is Wise Oil responsible for any costs?

Problem 4

Leases contributed to a JOA by Phillips are top leased by Sun. Litigation ensues and Sun ultimately prevails. In the interim, a commercial well is drilled. Phillips has paid its proportionate share of the costs to drill, complete and operate the well, but has not been reimbursed for all of its expenses.

When the JOA was signed, Phillips and Sun each had a 50% interest in the Contract Area. As a result of the court's decision, Phillips now only has 10% interest.

How will the interests of the parties be adjusted?

Problem 5

A lease contributed by Slick Oil Company becomes embroiled in litigation after the JOA is executed. During the course of litigation, Luckey Oil Company finds a commercial field which includes a part of the lease contributed by Slick. Slick paid its pro rata share of the costs to drill, complete and operate the well. Before Slick recovers its cost, it loses its lawsuit and the lease is judicially assigned to Sun.

Can Slick keep the production it has received up to the date of the court judgment?

Does Slick have any rights to future production?

Can Slick have the joint account pay for its legal costs?

Can Sun participate in the well?

Problem 6

A JOA was executed on December 1, 1985. Careless Oil, a Non-Operator, fails to make a shut-in payment due on June 1, 1986 and as a result, loses a lease. The parties to the JOA complete a commercial well on September 6, 1986.

Does Careless Oil share in production when the well is brought on stream?

What happens if Careless Oil reacquires the lease 50 days after it expired?

What if Careless Oil, as Operator, failed to pay a shut-in payment for a Non-Operator on a lease in which it had no interest?

Problem 7

On January 1, 1986, Sun, Texaco and Lario sign a JOA and agree to drill a well on or before July 1, 1986. The parties own the acreage in the following percentages on January 1, 1986.

Sun	40%	
Texaco	40%	(Operator)
Lario	20%	

The initial well is dry. A second well is spud on August 15, 1986 and is a prolific find. Sun contributed one lease to the JOA and this lease expired on July 15, 1986. (Option No. 1 on page 13 is checked.) Texaco and Lario take the position that Sun should not participate in the well. Sun deposits its share of the cost of the well in escrow and sues.

Who wins?

Problem 8

Economy Oil Company and Low Cost Gas Corporation become dissatisfied with the manner Exxon, as Operator, is conducting operations. Economy seeks to take over as Operator, contending that it could operate more efficiently and more economically. Low Cost agrees. Exxon refuses.

What can Economy and Low Cost do?

Problem 9

Slippery Oil Company sends Sun, Operator, a certified letter stating that if Sun conducts a drill stem test on the well, it will not pay for such test and will hold Sun liable for all losses sustained if the well bore is damaged as a result of the test.

What should Sun do?

Problem 10

After drilling an inconclusive initial test well, Sanguine Oil Company, on December 3, 1985, proposes three wells be drilled. The drilling rig is still on location when the notices are given. Go-Slow Energy objects and suggests that the parties evaluate the results of the first well before embarking on a three well program. Sanguine disagrees and tells Go-Slow it can drill all three wells for \$2.5MM within 90 days.

On December 6, 1985 Go-Slow sees its attorney and tells him that it wants to participate in only the first well.

What results?

Problem 11

Sun, as Operator, drills the initial test well to 3,000 feet where the bit hits granite. Sun contacts Lario while the rig is on site and proposes to drill 500 feet to the west, within the same quarter section. Lario's president agrees to the substitute test. (Each party has a 50% interest in the JOA.) Ten days later, Sun sends Lario an AFE for the substitute well. Lario says nothing. The well is dry.

Is Lario obligated to pay for the well?

Problem 12

Amoco, as Operator, drills a subsequent well to 11,000 feet which is TD. The well encounters a "minor" gas show at 7200 feet. The parties own to all depths in the drillsite. The Non-Operators, Jack Energy and Jill Energy, have a 60% interest in the JOA and notify Amoco, in accordance with Article VI.B.1., that they wish to plug back and complete at 7200 feet. Amoco ignores the notice to plug back and advises Jack and Jill that it is going to deepen the well to 14,500 feet. Jack and Jill run up to Denver to talk to Hill, their attorney. Hill informs Amoco that it is in violation of the JOA. Amoco tells Jack and Jill that, as Operator, it has the right to make such a decision and that Jack and Jill have, by their actions, elected not to participate.

Amoco drills a dry hole. Is Amoco liable to Jack and Jill?

Amoco drills a great well. Jack and Jill want their share of production. What results?

Problem 13

Sun, as Operator, is approached by the three Non-Operators and requested by them to sell their gas. Sun has a good contract and is confident that with a minimum of effort it could sell the Non-Operators' gas.

What should Sun do?

Problem 14

Exxon, Chevron and Chorney sign a JOA to drill a well to a depth of 18,000 feet or to adequately test the Prairie du Chein, whichever is the lesser depth. Chorney is Operator. At 12,000 feet, Chorney concludes that the prospective sand is located at least 3,000 feet deeper than expected. Although it is feasible to drill a 21,000 foot test, the cost will increase from \$7MM to \$12.5MM and Chorney recommends that the well be abandoned. Chevron agrees, but Exxon wants to drill.

Can Exxon force Chevron and Chorney to pay their proportionate share of the drilling expenses?

Problem 15

Astute Petroleum Company and Sun enter into a JOA and Sun is named Operator. The well is drilled to TD and Sun elects to go non-consent. Astute takes over operations and completes the well as a producer. Sun requests well information from Astute, but Astute refuses to supply such information. Sun has 30 days to exercise an option to drill under three option farmouts.

What is Sun's recourse?

Problem 16

Insolvent Oil, Texaco and AMOCO sign a JOA. AMOCO is the Operator. After two months of drilling a deep test, Insolvent stops paying its invoices.

What actions can AMOCO take?

Must AMOCO supply well information requested by Insolvent?

Can Insolvent participate in subsequent operations?

The well is drilled to TD. AMOCO recommends that the well be plugged and gives proper notice to the parties. Texaco disagrees. Insolvent does not respond.

Can Texaco take over the well?

Must Texaco carry Insolvent?

Problem 17

A blowout occurs in a national forest. The Operator spends \$600,000 to control the well and "clean" the area. Five days after the blowout, the Operator notifies the parties of the incident. Smokey Petroleum objects to what it views as outrageously high expenditures and it refuses to pay the invoices related to the blowout.

Is Smokey liable?

Problem 18

Sun and Thrifty Oil executed a JOA on May 1, 1985 which covered Sections 18 and 19. Sun contributed Section 18 and Thrifty contributed Section 19. The JOA called for a well to be spudded by June 15, 1985 on Section 18. Sun has a 50% interest in the JOA and Thrifty has a 50% interest in the JOA. The lease covering all of Section 19 called for a rental payment on May 15, 1985. On May 5, 1985, Thrifty notified Sun that it desired to surrender its lease on Section 19. Sun requested the lease and an assignment was made transferring Thrifty's interest to Sun.

Has the JOA terminated? Can Thrifty participate in the drilling of the well on Section 18? If so, on what basis?

If Sun drills on Section 19, does Thrifty still have a right to participate in the well?

Problem 19

Diamond Shamrock, Occidental, Sohio and Sun sign a JOA in which each party owns a 25% interest. Diamond Shamrock and Occidental contribute a jointly owned lease on Section 2. (Each owns 50% of the lease.) Sohio and Sun contribute a jointly owned lease on Section 3. (Each owns 50% of the lease.) The lease on Section 2 expires on January 1, 1986. On April 16, 1986, the parties bring in a marginal well on Section 3. On May 26, 1986, Occidental secures a lease on Section 2, but fails to record the lease until July 5, 1986. On August 8, 1986, Sun discovers that Occidental has acquired this lease and requests an interest in the lease. Occidental replies that it only need share the lease with Diamond Shamrock and that Diamond Shamrock does not want to acquire an interest in the lease. Sun objects.

Does Occidental have to share the lease with Sun?

Problem 20

On May 15, 1985, Sun and Texaco sign a JOA, covering Sections 19, 20, 21 and 22. On April 19, 1985, Sun acquires an option farmout from Cities Service on Section 19. On June 11, 1985, Sun acquires an option farmout from Quintana on Section 20. Both options were earned by the drilling of a well on Section 20, in which Sun and Texaco jointly drilled on a 50%-50% basis. The well was a prolific producer. Sun has refused to grant Texaco an interest in the option farmouts. Texaco sues.

Should Texaco prevail?

Problem 21

Exxon is the Operator of a well that blows out causing damage to 65 homes which are located in a subdivision near the well. Exxon did not obtain blow out insurance. Article X provides that Operator has settlement authority not to exceed \$10,000. During the next two weeks, Exxon, using a local law firm, is able to settle all but 2 of the 65 claims. The claims average \$5,000. Only 4 of the 63 claims settled exceeded \$10,000. Exxon submits an invoice to its partners for expenses incurred. In total, Exxon expended \$315,000 in settlement payments and \$24,500 in legal expenses.

Challenger Oil complains that it was not notified of the settlements and it objects to paying its proportionate share.

Will Exxon win?

Who pays the cost of Exxon's lawsuit against Challenger?

Problem 22

Sun and Slick Oil met on Friday October 11, 1985 to discuss whether a well jointly drilled pursuant to a JOA should be completed. Sun, as Operator, recommended completion. Slick reviewed the data and Slick's Manager of Geology consented at 1:45 p.m. on Friday to the completion attempt. Sun informed Slick that a completion attempt would be instituted on the following day, Saturday, October 12, 1985. Sun began the completion attempt on Saturday, as scheduled. On Tuesday, October 15, 1985 at 9:30 a.m., Slick's District Manager calls to say that Slick will not participate in the completion operation. When Sun refers to the Manager of Geology's statement of consent, Slick's District Manager replies, "he did not have the appropriate authority." The well is not completed as a producer.

Can Sun sue?

Problem 23

Sun and Lario agree to drill a well on a lease owned 50% by Sun and 50% by Lario. Lario is designated Operator and furnishes an AFE to Sun which is executed and returned to Lario. The parties exchange drafts of a JOA, but the JOA is never signed. Lario completes the well as a producer and has refused to share the proceeds with Sun.

Does a contract exist?

Problem 24

Sun, Arco and LL&E execute a JOA. Each Company owns a 33-1/3% interest in the JOA. Arco, as Operator, disseminates an AFE which specifies a dry hole cost of \$6MM for a deep test in Nevada. Sun and LL&E consent to the AFE. Arco's drilling contractor, Satisfaction Guaranteed, engages two prostitutes who are at the disposal of Arco's local Production Department. The well drills slowly. Eight months after commencing operation, ARCO disseminates a supplemental AFE which indicates a revised dry hole cost of \$8MM. A Sun employee visits Arco's local Production Office to discuss the increase in cost. During this visit, he becomes aware of the prostitutes.

Can Sun refuse to pay no more than 33-1/3% of \$6MM or \$2MM?