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INTRODUCTION

To facilitate the annual drilling of thousands of wells within the United States, the oil industry has relied on form agreements. The American Association of Petroleum Landmen (A.A.P.L.) has, since 1956, provided industry with standardized Joint Operating Agreements. The 1956 form was revised in 1977, 1982 and again in 1989. 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, this Manual reviews exhibits that are customarily attached to the Joint Operating Agreement.

Article XVI. 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 should 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.


I want to acknowledge my wonderfully talented secretary, Julie Whitmire. During the lengthy preparation process, Julie's positive attitude and eye for perfection substantially contributed to the success of this project.

I would also like to acknowledge my wife, Lynn Derman, who has always assisted me in attaining a healthy balance between my work and personal endeavors.
A.A.P.L. FORM 610 - 1989
MODEL FORM OPERATING AGREEMENT

OPERATING AGREEMENT
DATED

* * * * ____________, 19__.

* * * * OPERATOR ________________________________

* * * * CONTRACT AREA ________________________________

__________________________________________________

__________________________________________________

__________________________________________________

COUNTY OR PARISH OF ____________, STATE OF ____________
**Date:**
The date inserted should be consistent with the date included in Article XVI., lines 1 and 2, page 18. 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 (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 ______________, 19______ and attached hereto."

**Operator:**
This is the same person named in the body of the JOA. Be certain to use the proper corporate or partnership name.

**Contract Area:**
This is a brief description of lands covered by the JOA. For example NW of Section 16, Township 6 North -- Range 8 East. 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 XVI. (See Article XVI.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 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.
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The Table of Contents describes the provisions of the JOA. While not mandatory, some preparers delete references to provisions that have been deleted in the body of the JOA. For example, if the preferential right to purchase provision is deleted in the body of the JOA, a conspicuous line is run through such reference in the Table of Contents.
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OPERATING AGREEMENT

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 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 "AFE" shall mean an Authority for Expenditure prepared by a party to this agreement for the purpose of
estimating the costs to be incurred in conducting an operation hereunder.

B. The term "Completion" or "Complete" shall mean a single operation intended to complete a well as a producer of Oil
and Gas in one or more Zones, including, but not limited to, the setting of production casing, perforating, well stimulation
and production testing conducted in such operation.

C. The term "Contract Area" shall mean all of the lands, Oil and Gas Leases and/or Oil and Gas Interests intended to be
developed and operated for Oil and Gas purposes under this agreement. Such lands, Oil and Gas Leases and Oil and Gas
Interests are described in Exhibit "A."

D. The term "Deepen" shall mean a single operation whereby a well is drilled to an objective Zone below the deepest
Zone in which the well was previously drilled, or below the Deepest Zone proposed in the associated AFE, whichever is the
lesser.

E. 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.

F. 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 unless fixed by express agreement of the Drilling Parties.

G. The term "Drillsite" shall mean the Oil and Gas Lease or Oil and Gas Interest on which a proposed well is to be
located.

H. The term "Initial Well" shall mean the well required to be drilled by the parties hereto as provided in Article VI.A.

I. The term "Non-Consent Well" shall mean a well in which less than all parties have conducted an operation as
provided in Article VI.B.

J. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a
proposed operation.

K. The term "Oil and Gas" shall mean oil, gas, casinghead gas, gas condensate, and/or 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.

L. The term "Oil and Gas Interests" or "Interests" shall mean unleased fee and mineral interests in Oil and Gas in tracts
of land lying within the Contract Area which are owned by parties to this agreement.

M. The terms "Oil and Gas Lease," "Lease" and "Leasehold" shall mean the oil and gas leases or interests therein
covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

N. The term "Plug Back" shall mean a single operation whereby a deeper Zone is abandoned in order to attempt a
Completion in a shallower Zone.

O. The term "Recompletion" or "Recomplete" shall mean an operation whereby a Completion in one Zone is abandoned
in order to attempt a Completion in a different Zone within the existing wellbore.

P. The term "Rework" shall mean an operation conducted in the wellbore of a well after it is Completed to secure,
restore, or improve production in a Zone which is currently open to production in the wellbore. Such operations include, but
are not limited to, well stimulation operations but exclude any routine repair or maintenance work or drilling, Sidetracking,
Deepening, Completing, Recompleting, or Plugging Back of a well.

Q. The term "Sidetrack" shall mean the directional control and intentional deviation of a well from vertical so as to
take the bottom hole location used to drill right junk in the hole to overcome other
mechanical difficulties.

R. The term "Zone" shall mean a stratum of earth containing or thought to contain a common accumulation of Oil and
Gas separately producible from any other common accumulation of Oil and Gas.

Unless the context otherwise clearly indicates, words used in the singular include the plural, the word "person" includes
natural and artificial persons, the plural includes the singular, and any gender includes the masculine, feminine, and neuter.

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. Description of lands subject to this agreement,
2. Restrictions, if any, as to depths, formations, or substances,
3. Parties to agreement with addresses and telephone numbers for notice purposes,
4. Percentages or fractional interests of parties to this agreement,
5. Oil and Gas Leases and/or Oil and Gas Interests subject to this agreement,

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.
H. Other:
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 JOA does not provide for the use of master limited partnerships and their like; consequently, the JOA needs to be amended. 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

Definitions are important. Note that the term Oil and Gas is broadly defined and that Oil and Gas Interests includes unleased fee and mineral interests. 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 in the definition of Contract Area. If Exhibit "A" does not describe the Leases within the Contract Area, this line should be deleted.

Several additional definitions have been added in the 1989 Form. The inclusion of definitions for the terms Sidetrack, Rework, Zone, Plug Back, Completion or Complete, Deepen, Non-Consent Well, Initial Well and AFE should eliminate ambiguity and, consequently, conflict. The word "Affiliate" is used several times although it is not defined. Affiliate can be defined: The term Affiliate shall mean a company, partnership or other legal entity which controls, or is controlled by or which is controlled by an entity which controls a party to this agreement. Control means the ownership directly or indirectly of more than 50% of the shares or voting rights in a company, partnership or legal entity. The term "related party" appears in the last sentence of Article V.D.1. and it should be replaced with the term Affiliate. The definition of the terms Completion or Complete is extremely broad. They are defined as "a single operation intended to complete a well as a producer of Oil and Gas in one or more Zones, including, but not limited to, the setting of production
ARTICLE I.

DEFINITIONS

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

A. The term "AFE" shall mean an Authority for Expenditure prepared by a party to this agreement for the purpose of estimating the costs to be incurred in conducting an operation hereunder.

B. The term "Completion" or "Complete" shall mean a single operation intended to complete a well as a producer of Oil and Gas in one or more Zones, including, but not limited to, the setting of production casing, perforating, well stimulation and production testing conducted in such operation.

C. The term "Contract Area" shall mean all of the lands, Oil and Gas Leases and/or Oil and Gas Interests intended to be developed and operated for Oil and Gas purposes under this agreement. Such lands, Oil and Gas Leases and Oil and Gas Interests are described in Exhibit "A."

D. The term "Deepen" shall mean a single operation whereby a well is drilled to an objective Zone below the deepest Zone in which the well was previously drilled, or below the Deepest Zone proposed in the associated AFE, whichever is the lesser.

E. 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.

F. 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 unless fixed by express agreement of the Drilling Parties.

G. The term "Drillsite" shall mean the Oil and Gas Lease or Oil and Gas Interest on which a proposed well is to be located.

H. The term "Initial Well" shall mean the well required to be drilled by the parties hereto as provided in Article VI.A.

I. The term "Non-Consent Well" shall mean a well in which less than all parties have conducted an operation as provided in Article VI.B.

J. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

K. The term "Oil and Gas" shall mean oil, gas, casinghead gas, gas condensate, and/or 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.

L. The term "Oil and Gas Interests" or "Interests" shall mean unleased fee and mineral interests in Oil and Gas in tracts of land lying within the Contract Area which are owned by parties to this agreement.

M. The terms "Oil and Gas Lease," "Lease" and "Leasehold" shall mean the oil and gas leases or interests therein covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.

N. The term "Plug Back" shall mean a single operation whereby a deeper Zone is abandoned in order to attempt a Completion in a shallower Zone.

O. The term "Recompletion" or "Recomplete" shall mean an operation whereby a Completion in one Zone is abandoned in order to attempt a Completion in a different Zone within the existing wellbore.

P. The term "Rework" shall mean an operation conducted in the wellbore of a well after it is Completed to secure, restore, or improve production in a Zone which is currently open to production in the wellbore. Such operations include, but are not limited to, well stimulation operations but exclude any routine repair or maintenance work or drilling, Sidetracking, Deepening, Complet ing, Recompleting, or Plugging Back of a well.

Q. The term "Sidetrack" shall mean the directional control and intentional deviation of a well from vertical so as to change the bottom hole location unless done to straighten the hole or to drill around junk in the hole to overcome other mechanical difficulties.

R. The term "Zone" shall mean a stratum of earth containing or thought to contain a common accumulation of Oil and Gas separately producible from any other common accumulation of Oil and Gas. Unless the context otherwise clearly indicates, words used in the singular include the plural, the word "person" includes natural and artificial persons, the plural includes the singular, and any gender includes the masculine, feminine, and neuter.

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) Description of lands subject to this agreement,
(2) Restrictions, if any, as to depths, formations, or substances,
(3) Parties to agreement with addresses and telephone numbers for notice purposes,
(4) Percentages or fractional interests of parties to this agreement,
(5) Oil and Gas Leases and/or Oil and Gas Interests subject to this agreement,
(6) Burdens on production.

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.


H. Other:
Article I. DEFINITIONS
casing, perforating, artificial stimulation and production testing conducted in such operation."

The terms Completion or Complete have traditionally not been clearly defined. Rather, the definition was one created in the eyes of the beholder. At times, it has been argued that Completion occurred when a well was connected to a pipeline or was capable of pumping into a tank truck and all that was required was the turning of a valve. At other times, it has been argued (sometimes by the same party) that Completion occurred after a well had been tested or just perforated. Since the JOA may be attached as an exhibit to a farmout agreement or an exploration agreement, the definition of Completion in the JOA may be used to help define an otherwise undefined term (Completion) in the farmout agreement or the exploration agreement.

The parties may wish to amend the definition of Deepen in those instances where a horizontal well is anticipated, to make clear that the (horizontal) extension of a horizontal well is covered by the rules which govern the Deepening of a well (Article VI.A.4.). To accomplish this result, the definition can be expanded to read, "The term Deepen shall also mean a single operation whereby a Horizontal Well is drilled to a targeted horizontal distance beyond the horizontal distance in which the well was previously drilled, or beyond the targeted horizontal distance proposed in the associated AFE, whichever is the lesser." If the definition of Deepen is expanded as discussed, the term Horizontal Well should be defined in Article I to read, "The term 'Horizontal Well' shall mean a well in which the horizontal component of the gross Completion interval in the reservoir exceeds the vertical component of such gross Completion interval." For reasons discussed in connection with Article VI.B., the associated expense and risk of Horizontal Wells, parties who elect not to participate may be required to farmout or relinquish a portion of their interest and, consequently, the Deepening provisions of Article VI.B.4. may not apply. If the parties incorporate such optional farmout or relinquishment (blackout) provisions in Article XVI., no change of the definition of Deepening is required.

The word "or" was inadvertently dropped between the words "hole" and "to" on line 52 in the definition of Sidetrack.

Feel free to define other terms as may be required. Ensure that the language used in Article XVI. is consistent with the defined terms.
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 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 "AFE" shall mean an Authority for Expenditure prepared by a party to this agreement for the purpose of
estimating the costs to be incurred in conducting an operation hereunder.
B. The term "Completion" or "Complete" shall mean a single operation intended to complete a well as a producer of Oil
and Gas in one or more Zones, including, but not limited to, the setting of production casing, perforating, well stimulation
and production testing conducted in such operation.
C. The term "Contract Area" shall mean all of the lands, Oil and Gas Leases and/or Oil and Gas Interests intended to be
developed and operated for Oil and Gas purposes under this agreement. Such lands, Oil and Gas Leases and Oil and Gas
Interests are described in Exhibit "A."
D. The term "Deepen" shall mean a single operation whereby a well is drilled to an objective Zone below the deepest
Zone in which the well was previously drilled, or below the Deepest Zone proposed in the associated AFE, whichever is the
lesser.
E. 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.
F. 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 unless fixed by express agreement of the Drilling Parties.
G. The term "Drillsite" shall mean the Oil and Gas Lease or Oil and Gas Interest on which a proposed well is to be
located.
H. The term "Initial Well" shall mean the well required to be drilled by the parties hereto as provided in Article VI.A.
I. The term "Non-Consent Well" shall mean a well in which less than all parties have conducted an operation as
provided in Article VI.B.
J. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a
proposed operation.
K. The term "Oil and Gas" shall mean oil, gas, casinghead gas, gas condensate, and/or 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.
L. The term "Oil and Gas Interests" or "Interests" shall mean unleased fee and mineral interests in Oil and Gas in tracts
of land lying within the Contract Area which are owned by parties to this agreement.
M. The terms "Oil and Gas Lease," "Lease" and "Leasehold" shall mean the oil and gas leases or interests therein
covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.
N. The term "Plug Back" shall mean a single operation whereby a deeper Zone is abandoned in order to attempt a
Completion in a shallower Zone.
O. The term "Recompletion" or "Recomplete" shall mean an operation whereby a Completion in one Zone is abandoned
in order to attempt a Completion in a different Zone within the existing wellbore.
P. The term "Rework" shall mean an operation conducted in the wellbore of a well after it is Completed to secure,
restore, or improve production in a Zone which is currently open to production in the wellbore. Such operations include, but
are not limited to, well stimulation operations but exclude any routine repair or maintenance work or drilling, Sidetracking,
Deepening, Completing, Recompleting, or Plugging Back of a well.
Q. The term "Sidetrack" shall mean the directional control and intentional deviation of a well from vertical so as to
change the bottom hole location unless done to straighten the hole or to drill around junk in the hole to overcome other
mechanical difficulties.
R. The term "Zone" shall mean a stratum of earth containing or thought to contain a common accumulation of Oil and
Gas separately producible from any other common accumulation of Oil and Gas.

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) Description of lands subject to this agreement,
(2) Restrictions, if any, as to depths, formations, or substances,
(3) Parties to agreement with addresses and telephone numbers for notice purposes,
(4) Percentages or fractional interests of parties to this agreement,
(5) Oil and Gas Leases and/or Oil and Gas Interests subject to this agreement,
(6) Burdens on production.
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.
H. Other:
Article II. EXHIBITS

Check the appropriate boxes to indicate those exhibits that are attached. Frequently, Exhibit "B," Form of Lease, will not be attached. To ensure the Form is properly completed, only check those Exhibits that are included.

As a consequence of an addition incorporated in the 1989 Form, Exhibit "A" now must contain the phone number of the parties for notice purposes. This is a valid improvement. The parties' telecommunications information should also be included, if applicable.

In addition, all "[b]urdens on production" must now be disclosed on Exhibit "A." This is also an improvement, although because all existing burdens may not be known at the time of preparation of Exhibit "A," the parties may have to provide a mechanism for the assumption or sharing of certain then unknown burdens. While the drafters added a category "H." for "Other" Exhibits, the drafters did not elevate a Memorandum of Operating Agreement and Financing Statement to the status of a designated Exhibit. The author believes this was a mistake. A properly drafted Memorandum of Operating Agreement and Financing Statement can secure and protect a creditor's interest. By including a Memorandum of Operating Agreement and Financing Statement as a designated Exhibit, the drafters would have encouraged its use. (See Article XVI.P. for an example.)
If any provision of any exhibit, except Exhibits "E," "F" and "G," is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.

ARTICLE III

INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an Oil and Gas Interest in the Contract Area, that Interest shall be treated for all purposes of this agreement 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 shall be deemed to own both royalty interest in such lease and the interest of the lessee thereunder.

B. Interests of Parties in Costs and Production:

Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties as their interests are set forth in Exhibit "A." In the same manner, the parties shall also own all production of Oil and Gas from the Contract Area subject, however, to the payment of royalties and other burdens on production as described hereafter.

Regardless of which party has contributed any Oil and Gas Lease or Oil and Gas Interest on which royalty or other burdens may be payable and except as otherwise expressly provided in this agreement, each party shall pay or deliver, or cause to be paid or delivered, all burdens on its share of the production from the Contract Area up to, but not in excess of, the sum of:

1. Liabilities therefor.
2. Royalties.
3. Other burdens.

C. Subsequently Created Interests:

If any party has contributed hereto a Lease or Interest that is burdened with an assignment of production given as security for the payment of money, or if, after the date of this agreement, any party creates an overriding royalty, production payment, net profits interest, assignment of production or other burden payable out of production attributable to its working interest hereunder, such burden shall be deemed a "Subsequently Created Interest." Further, if any party has contributed hereto a Lease or Interest burdened with an overriding royalty, production payment, net profits interest, or other burden payable out of production created prior to the date of this agreement, and such burden is not shown on Exhibit "A," such burden also shall be deemed a Subsequently Created Interest to the extent such burden causes the burdens on such party's Lease or Interest to exceed the amount stipulated in Article III.B. above.

The party whose interest is burdened with the Subsequently Created Interest (the "Burdened Party") shall assume and alone bear, pay and discharge the Subsequently Created Interest and shall indemnify, defend and hold harmless the other parties from and against any liability therefor. Further, if the Burdened Party fails to pay, when due, its share of expenses chargeable hereunder, all provisions of Article VII.B. shall be enforceable against the Subsequently Created Interest in the same manner as they are enforceable against the working interest of the Burdened Party. If the Burdened Party is required under this agreement to assign or relinquish to any other party, or parties, all or a portion of its working interest and/or the production attributable thereto, said other party, or parties, shall receive said assignment and/or production free and clear of said Subsequently Created Interest, and the Burdened Party shall indemnify, defend and hold harmless said other party, or parties, from any and all claims and demands for payment asserted by owners of the Subsequently Created Interest.

ARTICLE IV.

TITLES

A. Title Examination:

Title examination shall be made on the Drillsite of any proposed well prior to commencement of drilling operations and, if a majority in interest of the Drilling Parties so request or Operator so elects, title examination shall be made on the entire Drilling Unit, or maximum anticipated Drilling Unit, of the well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable Leases. Each party contributing Leases and/or Oil and Gas Interests to be included in the Drillsite or Drilling Unit, if appropriate, shall furnish to Operator all abstracts (including federal lease status reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of the title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each Drilling Party. Costs incurred by Operator in procuring abstracts, fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in royalty opinions and division order title opinions) and other direct charges as provided in Exhibit "C" shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties, as such interests appear in Exhibit "A." Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements rendered in connection with Leases or Oil and Gas Interests contributed by such party. Operator shall be responsible for the preparation and recording of pooling designations or declarations and communitization agreements as well as the conduct of hearings before governmental agencies for the securing of spacing or pooling orders or any other orders necessary or appropriate to the conduct of operations hereunder. This shall not prevent any party from appearing on its own behalf at such hearings.

Costs incurred by Operator, including fees paid to outside attorneys, which are associated with hearings before governmental agencies, and which costs are necessary and proper for the activities contemplated under this agreement, shall be direct charges to the joint account and shall not be covered by the administrative overhead charges as provided in Exhibit "C."
Article III. INTERESTS OF PARTIES

A. OIL AND GAS INTERESTS

This provision is frequently deleted when the parties to the JOA do not own unleased Oil and Gas Interests. If this provision is deleted, the relative portions of lines 39 to 40 on page 10 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

All "production" is owned as allocated in Exhibit "A." The JOA does not pool revenues. Pursuant to Article VI.G. or Article VI.H., 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 and other burdens. The royalties and other burdens 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. The 1989 Form clarifies that "shared" royalties include all burdens on production up to the specified amount included in the blank, not merely lessor royalties. Generally, the blank should be filled in with the smallest burdened interest (royalty plus burdens) contributed to the JOA. If at least one lease contains a 1/8 royalty and no other burdens, complete the blank with the words "one-eighth (1/8)." 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 1/8 royalty will be paid by the party burdened by such excess obligation. However, if no party has a 1/8 royalty lease, the blank should be completed to reflect the lowest royalty payable under the terms of any lease plus any additional burdens. It should be noted that the 1982 Form spoke about the "payment of royalties" while the 1989 Form addresses "all burdens."

The 1989 Form attempts to clarify what has confused many, by explicitly providing that the parties should share burdens up to the amount provided for in the blank and individually shoulder all excess burdens. That is, all burdens in excess of the amount provided for in the blank. Interestingly, the drafters included an additional sentence which mandates that each party shall pay all burdens on the leases contributed by such party if the Contract Area is identical with the Drilling Unit for the productive Zone(s). This curious sentence protects a party for agreeing to insert an amount in the blank which exceeds its burdens. Such a sentence is not necessary.
ARTICLE III

INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an Oil and Gas Interest in the Contract Area, that Interest shall be treated for all purposes of this agreement 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 shall be deemed to own both royalty interest in such lease and the interest of the lessee thereunder.

B. Interests of Parties in Costs and Production:

Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties as their interests are set forth in Exhibit "A." In the same manner, the parties shall also own all production of Oil and Gas from the Contract Area subject, however, to the payment of royalties and other burdens on production as described hereafter.

C. Subsequently Created Interests:

Regardless of which party has contributed any Oil and Gas Lease or Oil and Gas Interest on which royalty or other burdens may be payable and except as otherwise expressly provided in this agreement, each party shall pay or deliver, or cause to be paid or delivered, all burdens on its share of the production from the Contract Area up to, but not in excess of, and shall indemnify, defend and hold the other parties free from any liability therefore.

B. Interests of Parties in Costs and Production:

Except as otherwise expressly provided in this agreement, if any party has contributed hereeto any Lease or Interest which is burdened with any royalty, overriding royalty, production payment or other burden on production in excess of the amounts stipulated above, such party so burdened shall assume and alone bear all such excess obligations and shall indemnify, defend and hold the other parties hereto harmless from any and all claims attributable to such excess burden. However, so long as the Drilling Unit for the productive Zone(s) is identical with the Contract Area, each party shall pay or deliver, or cause to be paid or delivered, all burdens on production from the Contract Area due under the terms of the Oil and Gas Lease(s) which such party has contributed to this agreement, and shall indemnify, defend and hold the other parties free from any liability therefor.

No party shall ever be responsible, on a price basis higher than the price received by such party, to any other party's lessor or royalty owner, and if such other party's lessor or royalty owner should demand and receive settlement on a higher price basis, the party contributing the affected Lease shall bear the additional royalty burden attributable to such higher price.

Nothing contained in this Article III.B. shall be deemed an assignment or cross-assignment of interests covered hereby, and in the event two or more parties contribute to this agreement jointly owned Leases, the parties' undivided interests in said Leaseholds shall be deemed separate leasehold interests for the purposes of this agreement.

C. Subsequently Created Interests:

If any party has contributed hereto a Lease or Interest that is burdened with an assignment of production given as security for the payment of money, or if, after the date of this agreement, any party creates an overriding royalty, production payment, net profits interest, assignment of production or other burden payable out of production attributable to its working interest hereunder, such burden shall be deemed a "Subsequently Created Interest." Further, if any party has contributed hereeto a Lease or Interest burdened with an overriding royalty, production payment, net profits interest, or other burden payable out of production created prior to the date of this agreement, and such burden is not shown on Exhibit "A," such burden also shall be deemed a Subsequently Created Interest to the extent such burden causes the burdens on such party's Lease or Interest to exceed the amount stipulated in Article III.B. above.

The party whose interest is burdened with the Subsequently Created Interest (the "Burdened Party") shall assume and alone bear, pay and discharge the Subsequently Created Interest and shall indemnify, defend and hold harmless the other parties from and against any liability therefor. Further, if the Burdened Party fails to pay, when due, its share of expenses chargeable hereunder, all provisions of Article VII.B. shall be enforceable against the Subsequently Created Interest in the same manner as they are enforceable against the working interest of the Burdened Party. If the Burdened Party is required under this agreement to assign or relinquish to any other party, or parties, all or a portion of its working interest and/or the production attributable thereto, said other party, or parties, shall receive said assignment and/or production free and clear of said Subsequently Created Interest, and the Burdened Party shall indemnify, defend and hold harmless said other party, or parties, from any and all claims and demands for payment asserted by owners of the Subsequently Created Interest.

ARTICLE IV.

TITLES

A. Title Examination:

Title examination shall be made on the Drillsite of any proposed well prior to commencement of drilling operations and, if a majority in interest of the Drilling Parties so request or Operator so elects, title examination shall be made on the entire Drilling Unit, or maximum anticipated Drilling Unit, of the well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable Leases. Each party contributing Leases and/or Oil and Gas Interests to be included in the Drillsite or Drilling Unit, if appropriate, shall furnish to Operator all abstracts (including federal lease status reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of the title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each Drilling Party. Costs incurred by Operator in procuring abstracts, fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in royalty opinions and division order title opinions) and other direct charges as provided in Exhibit "C" shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties, as such interests appear in Exhibit "A." Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements rendered in connection with Leases or Oil and Gas Interests contributed by such party. Operator shall be responsible for the preparation and recording of pooling designations or declarations and communization agreements as well as the conduct of hearings before governmental agencies for the securing of spacing or pooling orders or any other orders necessary or appropriate to the conduct of operations hereunder. This shall not prevent any party from appearing on its own behalf at such hearings. Costs incurred by Operator, including fees paid to outside attorneys, which are associated with hearings before governmental agencies, and which costs are necessary and proper for the activities contemplated under this agreement, shall be direct charges to the joint account and shall not be covered by the administrative overhead charges as provided in Exhibit "C."
Article III. INTERESTS OF PARTIES

B. INTERESTS OF PARTIES IN COSTS AND PRODUCTION (continued)

The last sentence of Article III.B. states that "[N]othing contained in this Article III.B. shall be deemed an assignment or cross-assignment of interest covered thereby." In most states the JOA contractually pools the leases within the Contract Area committed to the JOA by the executing parties. This contractual pooling is not considered to be a cross assignment of real property. Rather the parties have only agreed to share expenses and production, if any, produced during the term of the JOA. A minority of states, including Texas, California, Mississippi and Illinois have adopted the contrary view, and have applied the cross-conveyance theory. In accordance with this theory, parties to a pooling convey title to one another. In *Grillring Oil Co. v. Hughes*, 618 S.W. 2d 874 (Tex. Civ. App. 1981) there is some doubt whether the explicit disclaimer of cross-conveyance would be respected in a state which has adopted the cross-conveyance theory. Courts have traditionally respected the parties' desires to avoid the cross-conveyance theory with regard to poolings, and they should respect the parties' desires with regard to contractual poolings associated with the execution of a JOA. *Stumpf v. Fidelity Gas Co.*, 294 F.2d 886 (9th Cir. 1961); *Phillips Petroleum Co. v. Petterson*, 218 F.2d 926 (10th Cir. 1954), *cert. denied*, 344 US 947 (1955). For a discussion of whether a JOA forever freezes the interests of the parties, see R.T. Jordan, Jr., *The Interplay Between Operating Agreements and Unit Orders in Establishing Ownership of Production*, LANDMAN, Nov./Dec. 1988.

Occasionally, a well is drilled where different prospective Zones are owned by different parties or the same parties may own the Zones, but their percentage interest in the Zones may differ from Zone to Zone. Under these circumstances, it is necessary to allocate the well costs between the Zones. In his comprehensive and definitive article on this subject Mr. Salazar discusses the variety of common approaches and recommends including a method of allocation in the JOA whenever such an allocation can be anticipated. Salazar, *Allocation of Well Costs Between Zones With Different Ownership*, Oil, Gas and Mineral Law Section of the Texas Bar Section Report, Vol. 15, No. 4, May 1990.

C. SUBSEQUENTLY CREATED INTERESTS

The 1989 Form revised this provision to include in the definition of Subsequently Created Interest "a Lease or Interest that is burdened with an assignment of production given as security for the payment of money." In addition, the provision now requires all existing burdens to be shown on Exhibit "A." If the burden is not included on Exhibit "A," it will be deemed a Subsequently Created Interest. It is
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ARTICLE III
INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an Oil and Gas Interest in the Contract Area, that Interest shall be treated for all purposes of this agreement 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 shall be deemed to own both royalty interest in such lease and the interest of the lessee thereunder.

B. Interests of Parties in Costs and Production:

Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties as their interests are set forth in Exhibit "A." In the same manner, the parties shall also own all production of Oil and Gas from the Contract Area subject, however, to the payment of royalties and other burdens on production as described hereafter.

Regardless of which party has contributed any Oil and Gas Lease or Oil and Gas Interest on which royalty or other burdens may be payable and except as otherwise expressly provided in this agreement, each party shall pay or deliver, or cause to be paid or delivered, all burdens on its share of the production from the Contract Area up to, but not in excess of, 66% and shall indemnify, defend and hold the other parties free from any liability therefor.

C. Additional Costs:

Except as otherwise expressly provided in this agreement, if any party has contributed hereto any Lease or Interest which is burdened with any royalty, overriding royalty, production payment or other burden on production in excess of the amounts stipulated above, such party so burdened shall assume and alone bear all such excess obligations and shall indemnify, defend and hold the other parties hereto harmless from any and all claims attributable to such excess burden. However, so long as the Drilling Unit for the productive Zone(s) is identical with the Contract Area, each party shall pay or deliver, or cause to be paid or delivered, all burdens on production from the Contract Area due under the terms of the Oil and Gas Lease(s) which such party has contributed to this agreement, and shall indemnify, defend and hold the other parties free from any liability therefor.

No party shall ever be responsible, on a price basis higher than the price received by such party, to any other party's lessor or royalty owner, and if such other party's lessor or royalty owner should demand and receive settlement on a higher price basis, the party contributing the affected Lease shall bear the additional royalty burden attributable to such higher price.

Nothing contained in this Article III.B. shall be deemed an assignment or cross-assignment of interests covered hereby, and in the event two or more parties contribute to this agreement jointly owned Leases, the parties' undivided interests in said Leaseholds shall be deemed separate leasehold interests for the purposes of this agreement.

C. Subsequently Created Interests:

If any party has contributed hereto a Lease or Interest that is burdened with an assignment of production given as security for the payment of money, or if, after the date of this agreement, any party creates an overriding royalty, production payment, net profits interest, assignment of production or other burden payable out of production attributable to its working interest hereunder, such burden shall be deemed a "Subsequently Created Interest." Further, if any party has contributed hereto a Lease or Interest burdened with an overriding royalty, production payment, net profits interest, or other burden payable out of production created prior to the date of this agreement, and such burden is not shown on Exhibit "A," such burden also shall be deemed a Subsequently Created Interest to the extent such burden causes the burdens on such party's Lease or Interest to exceed the amount stipulated in Article III.B. above.

The party whose interest is burdened with the Subsequently Created Interest (the "Burdened Party") shall assume and bear alone, pay and discharge the Subsequently Created Interest and shall indemnify, defend and hold harmless the other parties from and against any liability therefor. Further, if the Burdened Party fails to pay, when due, its share of expenses chargeable hereunder, all provisions of Article VII.B. shall be enforceable against the Subsequently Created Interest in the same manner as they are enforceable against the working interest of the Burdened Party. If the Burdened Party is required under this agreement to assign or relinquish to any other party, or parties, all or a portion of its working interest and/or the production attributable thereto, said other party, or parties, shall receive said assignment and/or production free and clear of said Subsequently Created Interest, and the Burdened Party shall indemnify, defend and hold harmless said other party, or parties, from and against any and all claims and demands for payment asserted by owners of the Subsequently Created Interest.

ARTICLE IV.

TITLES

A. Title Examination:

Title examination shall be made on the Drillsite of any proposed well prior to commencement of drilling operations and, if a majority in interest of the Drilling Parties so request or Operator so elects, title examination shall be made on the entire Drilling Unit, or maximum anticipated Drilling Unit, of the well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty, and production payments under the applicable Leases. Each party contributing Leases and/or Oil and Gas Interests to be included in the Drillsite or Drilling Unit, if appropriate, shall furnish to Operator all abstracts (including federal lease status reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of the title, shall be obtained by Operator. Owner shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each Drilling Party. Costs incurred by Operator in procuring abstracts, fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in royalty opinions and division order title opinions) and other direct charges as provided in Exhibit "C" shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties, as such interests appear in Exhibit "A." Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

Each party shall be responsible for securing curative matter and pooling amendments or agreements rendered in connection with Leases or Oil and Gas Interests contributed by such party. Operator shall be responsible for the preparation and recording of pooling designations or declarations and communization agreements as well as the conduct of hearings before governmental agencies for the securing of spacing or pooling orders or any other orders necessary or appropriate to the conduct of operations hereunder. This shall not prevent any party from appearing on its own behalf at such hearings. Costs incurred by Operator, including fees paid to outside attorneys, which are associated with hearings before governmental agencies, and which costs are necessary and proper for the activities contemplated under this agreement, shall be direct charges to the joint account and shall not be covered by the administrative overhead charges as provided in Exhibit "C."
Article III. INTERESTS OF PARTIES

C. SUBSEQUENTLY CREATED INTERESTS (continued)

now absolutely critical that the parties fully disclose existing burdens on Exhibit "A."

The second paragraph provides that if a Burdened Party fails to timely pay its share of expenses and the Burdened Party has created a Subsequently Created Interest, the financial obligations are enforceable against the Subsequently Created Interest. Can this provision bind a Subsequently Created Interest acquired by a bona fide purchaser for value? I do not believe it can. This provision is only effective to the extent a subsequent owner is provided notice of the terms of the JOA. The filing of a Memorandum of Operating Agreement and Financing Statement would provide suitable notice. See Rooker, Acquiring Interest in an Area Covered by a Joint Operating Agreement, LANDMAN, July/Aug. 1988.

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. To avoid problems of this nature, JOAs can be amended to require the assignor to obtain the assignee's assumption or ratification of the JOA.

Article IV. TITLES

A. TITLE EXAMINATION

The 1989 Form clarifies an often contentious point by providing that a title examination of the Drilling Unit, as opposed to only the drillsite, shall be done if requested by "a majority in interest of the Drilling Parties" or by the Operator. This is an improvement, as the 1982 Form required that all the Drilling Parties consent to a Drilling Unit title opinion for the costs thereof to be shared. In the 1989 Form, copies of all drilling title opinions are to be given to only the Drilling Parties, who paid for the opinions. The 1982 Form provides that copies of the drilling title opinions are to be given to all parties. The cost of title opinions are borne by the Drilling Parties. The 1989 Form eliminates the option to charge title costs against the Operator's administrative overhead.
ARTICLE III

INTERESTS OF PARTIES

** * * 5

A. Oil and Gas Interests:

If any party owns an Oil and Gas Interest in the Contract Area, that Interest shall be treated for all purposes of this agreement 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 shall be deemed to own both royalty interest in such lease and the interest of the lessee thereunder.

B. Interests of Parties in Costs and Production:

- Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties as their interests are set forth in Exhibit "A." In the same manner, the parties shall also own all production of Oil and Gas from the Contract Area subject, however, to the payment of royalties and other burdens on production as described hereafter.

- Regardless of which party has contributed any Oil and Gas Lease or Oil and Gas Interest on which royalty or other burdens may be payable and except as otherwise expressly provided in this agreement, each party shall pay or deliver, or cause to be paid or delivered, all burdens on its share of the production from the Contract Area up to, but not in excess of, the burden of the party whose interest is so burdened. Any and all claims and demands for payment asserted by owners of the Subsequently Created Interest.

- Nothing contained in this Article III.B. shall be deemed an assignment or cross-assignment of interests covered hereby, and in the event two or more parties contribute to this agreement jointly owned Leases, the parties' undivided interests in said Leaseholds shall be deemed separate leasehold interests for the purposes of this agreement.

C. Subsequently Created Interests:

- If any party has contributed hereto a Lease or Interest that is burdened with an assignment of production given as security for the payment of money, or if, after the date of this agreement, any party creates an overriding royalty, production payment, net profits interest, assignment of production or other burden payable out of production attributable to its working interest hereunder, such burden shall be deemed a "Subsequently Created Interest." Further, if any party has contributed hereto a Lease or Interest burdened with an overriding royalty, production payment, net profits interest, or other burden payable out of production created prior to the date of this agreement, and such burden is not shown on Exhibit "A," such burden also shall be deemed a Subsequently Created Interest to the extent such burden causes the burdens on such party's Lease or Interest to exceed the amount stipulated in Article III.B. above.

- The party whose interest is burdened with the Subsequently Created Interest (the "Burdened Party") shall assume and bear, pay and discharge the Subsequently Created Interest and shall indemnify, defend and hold harmless the other parties from and against any liability therefor. Further, if the Burdened Party fails to pay, when due, its share of expenses chargeable hereunder, all provisions of Article VII.B. shall be enforceable against the Subsequently Created Interest in the same manner as they are enforceable against the working interest of the Burdened Party. If the Burdened Party is required under this agreement to assign or relinquish to any other party, or parties, all or a portion of its working interest and/or the production attributable thereto, said other party, or parties, shall receive said assignment and/or production free and clear of all Subsequently Created Interest, and the Burdened Party shall indemnify, defend and hold harmless said other party, or parties, from any and all claims and demands for payment asserted by owners of the Subsequently Created Interest.

ARTICLE IV.

TITLES

A. Title Examination:

Title examination shall be made on the Drillsite of any proposed well prior to commencement of drilling operations and, if a majority in interest of the Drilling Parties so request or Operator so elects, title examination shall be made on the entire Drilling Unit, or maximum anticipated Drilling Unit, of the well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable Leases. Each party contributing Leases and/or Oil and Gas Interests to be included in the Drillsite or Drilling Unit, if appropriate, shall furnish to Operator all abstracts (including federal lease status reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of the title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each Drilling Party. Costs incurred by Operator in procuring abstracts, fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in royalty opinions and division order title opinions) and other direct charges as provided in Exhibit "C" shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties, as such interests appear in Exhibit "A." Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

- Each party shall be responsible for securing curative matter and pooling amendments or agreements rendered in connection with Leases or Oil and Gas Interests contributed by such party. Operator shall be responsible for the preparation and recording of pooling designations or declarations and communization agreements as well as the conduct of hearings before governmental agencies for the securing of spacing or pooling orders or any other orders necessary or appropriate to the conduct of operations hereunder. This shall not prevent any party from appearing on its own behalf at such hearings.

- Costs incurred by Operator, including fees paid to outside attorneys, which are associated with hearings before governmental agencies, and which costs are necessary and proper for the activities contemplated under this agreement, shall be direct charges to the joint account and shall not be covered by the administrative overhead charges as provided in Exhibit "C."
Article IV. TITLES

A. TITLE EXAMINATION (continued)

Outside attorneys' fees associated with hearings before government agencies are now chargeable to the joint account, but services rendered by in-house counsel are not. In-house counsel expenses should also be a direct charge. Such expenses should be based on an attorney's salary plus benefits. Attorneys that charge for their time would need to keep appropriate time records. This is a common practice among those companies that participate in international oil and gas activities. As currently written, it will be more expensive to conduct hearings before government agencies. This language benefits outside firms at the oil companies' expense. In appropriate circumstances, consider deleting the limitation to allow both outside and in-house legal fees to be chargeable to the joint account.

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 examining attorney or by all Drilling Parties. On occasion, this provision is amended to provide that the 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, 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.

B. LOSS OR FAILURE OF TITLE

The ownership of only a wellbore lease will not now, in and of itself, give a party an interest in the Contract Area. In some areas, especially Oklahoma, wellbore assignments have become prevalent. Unless Exhibit "A" gives the owner of only a wellbore interest an interest in the Contract Area, the owner of the wellbore is not considered a party to the JOA for purposes of contractual pooling.

As drafted, this provision imposes losses upon the party contributing the lease. 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.
2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, or other payment necessary to maintain all or a portion of an Oil and Gas Lease or Interest is not paid or is erroneously paid, and as a result a Lease or Interest terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new Lease or Interest covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties reflected on Exhibit "A" shall be revised on an acreage basis, effective as of the date of termination of the Lease or Interest involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the Lease or Interest which has terminated. If the party who failed to make the 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 the lost Lease or Interest, calculated on an acreage basis, for the development and operating costs previously paid on account of such Lease or Interest, it shall be reimbursed for unrecovered actual costs previously paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of Oil and Gas produced prior to termination of the Lease or Interest, less operating expenses and lease burdens chargeable hereunder to the person who failed to make payment, previously accrued to the credit of the lost Lease or Interest, on an acreage basis, up to the amount of unrecovered costs;
(b) Proceeds of Oil and Gas, less operating expenses and lease burdens chargeable hereunder to the person who failed to make payment, up to the amount of unrecovered costs attributable to that portion of Oil and Gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such Lease or Interest termination, would be attributable to the lost Lease or Interest on an acreage basis and which as a result of such Lease or Interest termination is credited to other parties, the proceeds of said portion of the Oil and Gas to be contributed by the other parties in proportion to their respective interests reflected on Exhibit "A"; and,
(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 Lease or Interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: All losses of Leases or Interests committed to this agreement, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall be joint losses and shall be borne by all parties in proportion to their interests shown on Exhibit "A." This shall include but not be limited to the loss of any Lease or Interest through failure to develop or because express or implied covenants have not been performed (other than performance which requires only the payment of money), and the loss of any Lease by expiration at the end of its primary term if it is not renewed or extended. There shall be no readjustment of interests in the remaining portion of the Contract Area on account of any joint loss.

4. Curing Title: In the event of a Failure of Title under Article IV.B.1. or a loss of title under Article IV.B.2. above, any Lease or Interest acquired by any party hereto (other than the party whose interest has failed or was lost) during the ninety (90) day period provided by Article IV.B.1. and Article IV.B.2. above covering all or a portion of the interest that has failed or was lost shall be offered at cost to the party whose interest has failed or was lost, and the provisions of Article VIII.B. shall not apply to such acquisition.
Article IV. TITLES

B. LOSS OR FAILURE OF TITLE (continued)

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 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 its 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, and it is fortunate to have paid for a well that finds oil or gas, it can recover its 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. As a consequence of a new provision which has been incorporated into the 1989 Form, any Lease or Interest lost as a result of the operation of an expressed or implied covenant (other than the payment of money) or the running of the primary term is expressly considered to be a joint loss.

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 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.
B. Loss or Failure of Title:

**Failure of Title:** Should any Oil and Gas Interest or Oil and Gas Lease be lost through failure of title, which results in a reduction of interest from that shown on Exhibit "A," the party credited with contributing the affected Lease or Interest (including, if applicable, a successor in interest to such party) shall have ninety (90) days from final determination of title failure to acquire a new lease or other instrument curing the entirety of the title failure, which 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 and Gas Leases and Interests; and,

(a) The party credited with contributing the Oil and Gas Lease or Interest affected by the title failure (including, if applicable, a successor in interest to such party) shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development or operating costs which it may have previously paid or incurred, but there shall be no additional liability on its part to the other parties hereto by reason of such title failure;

(b) There shall be no retroactive adjustment of expenses incurred or revenues received from the operation of the Lease or Interest which has failed, but the interests of the parties contained on Exhibit "A" shall be revised on an acreage basis, as of the time it is determined finally that title failure has 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 Area by the amount of the Lease or Interest failed;

(c) If the proportionate interest of the other parties hereto in any producing well previously drilled on the Contract Area is increased by reason of the title failure, the party who bore the costs incurred in connection with such well attributable to the Lease or Interest which has failed shall receive the proceeds attributable to the increase in such interest (less costs and burdens attributable thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well attributable to such failed Lease or Interest;

(d) Should any person not a party to this agreement, who is determined to be the owner of any Lease or Interest which has 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 who bore the costs which are so refunded;

(e) Any liability to account to a person not a party to this agreement for prior production of Oil and Gas which arises by reason of title failure shall be borne severally by each party (including a predecessor to a current party) who received production for which such accounting is required based on the amount of such production received, and each such party shall severally indemnify, defend and hold harmless all other parties hereto for any such liability to account;

(f) No charge shall be made to the joint account for legal expenses, fees or salaries in connection with the defense of the Lease or Interest claimed to have failed, but if the party contributing such Lease or Interest hereto elects to defend its title it shall bear all expenses in connection therewith; and

(g) If any party is given credit on Exhibit "A" to a Lease or Interest which is limited solely to ownership of an interest in the wellbore of any well or wells and the production therefrom, such party's absence of interest in the remainder of the Contract Area shall be considered a Failure of Title as to such remaining Contract Area unless that absence of interest is reflected on Exhibit "A."

2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight, any rental, shut-in well payment, minimum royalty or royalty payment, or other payment necessary to maintain all or a portion of an Oil and Gas Lease or Interest is not paid or is erroneously paid, and as a result a Lease or Interest terminates, there shall be no monetary liability against the party who failed to make such payment. Unless the party who failed to make the required payment secures a new Lease or Interest covering the same interest within ninety (90) days from the discovery of the failure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of the parties reflected on Exhibit "A" shall be revised on an acreage basis, effective as of the date of termination of the Lease or Interest involved, and the party who failed to make proper payment will no longer be credited with an interest in the Contract Area on account of ownership of the Lease or Interest which has terminated. If the party who failed to make the 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 the lost Lease or Interest, calculated on an acreage basis, for the development and operating costs previously paid on account of such Lease or Interest, it shall be reimbursed for unrecovered actual costs previously paid by it (but not for its share of the cost of any dry hole previously drilled or wells previously abandoned) from so much of the following as is necessary to effect reimbursement:

(a) Proceeds of Oil and Gas produced prior to termination of the Lease or Interest, less operating expenses and lease burdens chargeable hereunder to the person who failed to make payment, previously accrued to the credit of the lost Lease or Interest, on an acreage basis, up to the amount of unrecovered costs;

(b) Proceeds of Oil and Gas, less operating expenses and lease burdens chargeable hereunder to the person who failed to make payment, up to the amount of unrecovered costs attributable to that portion of Oil and Gas thereafter produced and marketed (excluding production from any wells thereafter drilled) which, in the absence of such Lease or Interest termination, would be attributable to the lost Lease or Interest on an acreage basis and which as a result of such Lease or Interest termination is credited to other parties, the proceeds of said portion of the Oil and Gas to be contributed by the other parties in proportion to their respective interests reflected on Exhibit "A"; and,

(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 Lease or Interest lost, for the privilege of participating in the Contract Area or becoming a party to this agreement.

3. Other Losses: Any losses of Leases or Interests committed to this agreement, other than those set forth in Articles IV.B.1. and IV.B.2. above, shall be joint losses and shall be borne by all parties in proportion to their interests shown on Exhibit "A." This shall include but not be limited to the loss of any Lease or Interest through failure to develop or because of any implied covenants that have not been performed (other than performance which requires only the payment of money), and the loss of any Lease by expiration at the end of its primary term if it is not renewed or extended. There shall be no readjustment of interests in the remaining portion of the Contract Area on account of any joint loss.

4. Curing Title: In the event of a Failure of Title under Article IV.B.1. or a loss of title under Article IV.B.2. above, any Lease or Interest acquired by any party hereto (other than the party whose interest has failed or was lost) during the ninety (90) day period provided by Article IV.B.1. and Article IV.B.2. above covering all or a portion of the interest that has failed or was lost shall be offered to the party whose interest has failed or was lost, and the provisions of Article VIII.B. shall not apply to such acquisition.
Article IV. TITLES

B. LOSS OR FAILURE OF TITLE (continued)

The Fifth Circuit Court of Appeals held in Fuller v. Phillips Petroleum Co., 872 F.2d 655 (5th Cir. 1989) that the JOA contained no expressed or implied obligation to notify a Non-Operator of an impending lease termination. The Operator in this case notified the Non-Operator of the lease termination after the lease had expired. The Non-Operator alleged that the Operator had a duty under the JOA to notify the Non-Operator of the lease termination date prior to such termination. The court rejected the Non-Operator's arguments that the JOA provisions dealing with plugging and abandonment and surrender necessitate prior notice of a lease termination.

Finally, the drafters provided that any Lease or Interest acquired by a party to the JOA within 90 days of its expiration, shall be offered at cost to the party who has lost the Lease or Interest to enable that party to maintain its interest in the Contract Area.

To transform the JOA to a joint loss agreement, it is only necessary to:


2. Delete the phrase "other than those set forth in Articles IV.B.1. and IV.B.2. above" in Article IV.B.3.

3. In Article VII.E., change the reference at the end of the first grammatical paragraph from "Article IV.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.
ARTICLE V.

OPERATOR

A. Designations 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. In its performance of services hereunder for the Non-Operators, Operator shall be an independent contractor
not subject to the control or direction of the Non-Operators except as to the type of operation to be undertaken in accordance
with the election procedures contained in this agreement. Operator shall not be deemed, or hold itself out as, the agent of the
Non-Operators with authority to bind them to any obligation or liability assumed or incurred by Operator as to any third
party. Operator shall conduct its activities under this agreement as a reasonable prudent operator, in a good and workmanlike
manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and
regulation, but in no event shall it have any 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:

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 for good cause by the affirmative vote of Non-Operators owning a majority interest
based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator; such vote shall not be
deemed effective until a written notice has been delivered to the Operator by a Non-Operator detailing the alleged default and
Operator has failed to cure the default within thirty (30) days from its receipt of the notice or, if the default concerns an
operation then being conducted, within forty-eight (48) hours of its receipt of the notice. For purposes hereof, "good cause" shall
mean not only gross negligence or willful misconduct but also the material breach of or inability to meet the standards of
operation contained in Article V.A. or material failure or inability to perform its obligations under this agreement.

2. Selection of Successor Operator: Upon the resignation or removal of Operator under any provision of this agreement, 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 or is deemed to have resigned fails to vote or votes only to
succeed itself, the successor Operator shall be selected by the affirmative vote of the party or 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 or resigned. The former Operator shall promptly deliver to the successor Operator all records and data relating to
the operations conducted by the former Operator to the extent such records and data are not already in the possession of the
successor operator. Any cost of obtaining or copying the former Operator's records and data shall be charged to the joint
account.

3. Effect of Bankruptcy: If Operator becomes insolvent, bankrupt or is placed in receivership, it shall be deemed to have
resigned without any action by Non-Operators, except the selection of a successor. If a petition for relief under the federal
bankruptcy laws is filed by or against Operator, and the removal of Operator is prevented by the federal bankruptcy court, all
Non-Operators and Operator shall comprise an interim operating committee to serve until Operator has elected to reject or
assume this agreement pursuant to the Bankruptcy Code, and an election to reject this agreement by Operator as a debtor in
possession, or by a trustee in bankruptcy, shall be deemed a resignation as Operator without any action by Non-Operators,
except the selection of a successor. During the period of time the operating committee controls operations, all actions shall
require the approval of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A." In the
event there are only two (2) parties to this agreement, during the period of time the operating committee controls
operations, a third party acceptable to Operator, Non-Operator and the federal bankruptcy court shall be selected as a
member of the operating committee, and all actions shall require the approval of two (2) members of the operating
committee without regard for their interest in the Contract Area based on Exhibit "A."

C. Employees and Contractors:

The number of employees or contractors 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 or
contractors shall be the employees or contractors of Operator.

D. Rights and Duties of Operator:

1. Competitive Rates and Use of Affiliates: 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. All work performed or materials supplied by affiliates or related parties of Operator
shall be performed or supplied at competitive rates, pursuant to written agreement, and in accordance with customs and
standards prevailing in the industry.

2. Discharge of Joint Account Obligations: Except as herein otherwise specifically provided, Operator shall promptly pay
and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall
charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in Exhibit "C."
Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits
made and received.

3. Protection from Liens: Operator shall pay, or cause to be paid, as and when they become due and payable, all accounts
of contractors and suppliers and wages and salaries for services rendered or performed, and for materials supplied on, to or in
respect of the Contract Area or any operations for the joint account thereof, and shall keep the Contract Area free from
Article V. OPERATOR

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. The 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. The Operator shall conduct its activities "as a reasonable prudent operator, in a good workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and regulation." The Operator's standard of care under the 1989 Form has been expanded. The 1982 Form only provided that the Operator "shall conduct all such operations in a good and workmanlike manner." See Arkla Exploration Co. v. Shadid, 710 P.2d 126 (Okla. Ct. App. 1985), where the Oklahoma Court of Appeals upheld the Oklahoma Corporation Commission's order that the Operator of a forced pooled drilling and spacing unit acted imprudently in conducting operations. The Commission found that the reasonable cost of the well was $3,108,740 and not the $6,249,294 charged by the Operator.

3. The 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 its own negligence where the language is clear and unequivocal. In Hamilton v. Texas Oil & Gas Corp., 648 S.W.2d 316 (Tex. Civ. App. 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 other performance schedule, which explicitly delineates the course of conduct expected. See also Tenneco Oil Co. v. Bogert, 630 F. Supp. 961 (W.D. Okla. 1986), (the Operator did not violate its fiduciary duty by not drilling additional wells where it knew of drainage by a well it had drilled on an adjacent track); Lancaster v. Petroleum Corp. of Delaware, 491 So.2d 768,
ARTICLE V.

OPERATOR

A. Designations 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. In its performance of services hereunder for the Non-Operators, Operator shall be an independent contractor
not subject to the control or direction of the Non-Operators except as to the type of operation to be undertaken in accordance
with the election procedures contained in this agreement. Operator shall not be deemed, or hold itself out as, the agent of the
Non-Operators with authority to bind them to any obligation or liability assumed or incurred by Operator as to any third
party. Operator shall conduct its activities under this agreement as a reasonable prudent operator, in a good and workmanlike
manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and
regulation, but in no event shall it have any 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:

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 only for good cause by the affirmative vote of Non-Operators owning a majority interest
based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator; such vote shall not be
deprecated effective until a written notice has been delivered to the Operator by a Non-Operator detailing the alleged default and
Operator has failed to cure the default within thirty (30) days from its receipt of the notice or, if the default concerns an
operation then being conducted, within forty-eight (48) hours of its receipt of the notice. For purposes hereof, "good cause" shall
mean not only gross negligence or willful misconduct but also the material breach of or inability to meet the standards of
operation contained in Article V.A. or material failure or inability to perform its obligations under this agreement.

2. Selection of Successor Operator: Upon the resignation or removal of Operator under any provision of this agreement, 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 or is deemed to have resigned fails to vote or votes only to
succeed itself, the successor Operator shall be selected by the affirmative vote of the party or 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 or resigned. The former Operator shall promptly deliver to the successor Operator all records and data relating to
the operations conducted by the former Operator to the extent such records and data are not already in the possession of the
successor operator. Any cost of obtaining or copying the former Operator's records and data shall be charged to the joint
account.

3. Effect of Bankruptcy: If Operator becomes insolvent, bankrupt or is placed in receivership, it shall be deemed to have
resigned without any action by Non-Operators, except the selection of a successor. If a petition for relief under the federal
bankruptcy laws is filed by or against Operator, and the removal of Operator is prevented by the federal bankruptcy court, all
Non-Operators and Operator shall comprise an interim operating committee to serve until Operator has elected to reject or
assume this agreement pursuant to the Bankruptcy Code, and an election to reject this agreement by Operator as a debtor in
possession, or by a trustee in bankruptcy, shall be deemed a resignation as Operator without any action by Non-Operators,
except the selection of a successor. During the period of time the operating committee controls operations, all actions shall
require the approval of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A." In the
event there are only two (2) parties to this agreement, during the period of time the operating committee controls
operations, a third party acceptable to Operator, Non-Operator and the federal bankruptcy court shall be selected as a
member of the operating committee, and all actions shall require the approval of two (2) members of the operating
committee without regard for their interest in the Contract Area based on Exhibit "A."

C. Employees and Contractors:

The number of employees or contractors 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 or
contractors shall be the employees or contractors of Operator.

D. Rights and Duties of Operator:

1. Competitive Rates and Use of Affiliates: 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. All work performed or materials supplied by affiliates or related parties of Operator
shall be performed or supplied at competitive rates, pursuant to written agreement, and in accordance with customs and
standards prevailing in the industry.

2. Discharge of Joint Account Obligations: Except as herein otherwise specifically provided, Operator shall promptly pay
and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall
charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in Exhibit "C."
Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits
made and received.

3. Protection from Liens: Operator shall pay, or cause to be paid, as and when they become due and payable, all accounts
of contractors and suppliers and wages and salaries for services rendered or performed, and for materials supplied on, to or in
respect of the Contract Area or any operations for the joint account thereof, and shall keep the Contract Area free from
Article V. OPERATOR

A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR (continued)

reh. den. (1986); Argos Resources, Inc. v. May Petroleum, Inc., 693 S.W.2d 663 (Tex. App. 1985) (the failure to send supplemental AFEs was not gross negligence). See C&C Partners v. Sun Exploration and Production Co., 783 S.W.2d 707 (Tex. App. 1990) (a Non-Operator was held not to be a "consumer" within the purview of the Texas Deceptive Trade Practices Act).

The Fifth Circuit Court of Appeals, in Huggs, Inc. v. LPC Energy, Inc., 889 F.2d 649 (5th Cir. 1989) held that the Operator did not violate the standard of care as provided for in Article V, where a lease was lost, due to the Operator's failure to timely pay delay rentals. The standard of care was overridden by the JOA's explicitly clear provision (Article IV.B.2. of the 1989 Form) which exculpated the Operator from liability for inadvertent loss of leases through negligent mistakes or oversight in the payment of delay rentals.

Several authors have raised the question of whether the exculpatory or indemnity provision contained in Article V.A., which only holds the Operator liable for "gross negligence or willful misconduct," is sufficient to allow the Operator to avoid the full consequence of his negligence. Courts, in the name of public policy, have been growing reluctant to sanction exculpatory or indemnity provisions which insulate a party from his own negligence. Frequently, it is required that such provision be clear and conspicuous. Pursuant to the JOA, a negligent Operator is liable for only its percentage interest, not the percentage interest of the Non-Operators. See Hardick The 1982 Model Form Operating Agreement: Changes and Continuing Concerns, Oil and Gas Agreements 8-21, ROCKY MNT. MIN. L. FDN. (1983). See also Haring v. Bay Rock Corp., 773 S.W.2d 676 (Tex. App. 1989) (the JOA is within the scope of the Texas Anti-Indemnity Statute and the language does not satisfy the express negligence test).

No A.A.P.L. form, including the 1989 Form, has addressed the issue of Operator's liability for consequential and punitive damages which could be sought by Non-Operators and third parties where the loss sustained is caused by the Operator's gross negligence or willful misconduct. In light of the Valdez spill and other environmental catastrophes, the incorporation of an additional provision which addresses this issue could prove valuable. In the 1990 Model Form International Operating Agreement, developed jointly by the International Energy Committee of the American Corporate Counsel Association and the Association of International
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Non-Operators with authority to bind them to any obligation or liability assumed or incurred by Operator as to any third
party. Operator shall conduct its activities under this agreement as a prudent operator, in a good and workmanlike
manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and
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interest in the Contract Area at the time such successor Operator is selected. The successor Operator shall be selected by the
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however, if an Operator which has been removed or is deemed to have resigned fails to vote or votes only to
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removed or resigned. The former Operator shall promptly deliver to the successor Operator all records and data relating to
the operations conducted by the former Operator to the extent such records and data are not already in the possession of the
successor operator. Any cost of obtaining or copying the former Operator's records and data shall be charged to the joint
account.

3. Effect of Bankruptcy: If Operator becomes insolvent, bankrupt or is placed in receivership, it shall be deemed to have
resigned without any action by Non-Operators, except the selection of a successor. If a petition for relief under the federal
bankruptcy laws is filed by or against Operator, and the removal of Operator is prevented by the federal bankruptcy court, all
Non-Operators and Operator shall comprise an interim operating committee to serve until Operator has elected to reject or
assume this agreement pursuant to the Bankruptcy Code, and an election to reject this agreement by Operator as a debtor in
possession, or by a trustee in bankruptcy, shall be deemed a resignation as Operator without any action by Non-Operators,
except the selection of a successor. During the period of time the operating committee controls operations, all actions shall be
required of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A." In the event there are only two (2) parties to this agreement, during the period of time the operating committee controls
operations, a third party acceptable to Operator, Non-Operator and the federal bankruptcy court shall be selected as a
member of the operating committee, and all actions shall require the approval of two (2) members of the operating
committee without regard for their interest in the Contract Area based on Exhibit "A."

C. Employees and Contractors:

The number of employees or contractors 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 or
contractors shall be the employees or contractors of Operator.

D. Rights and Duties of Operator:

1. Competitive Rates and Use of Affiliates: 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. All work performed or materials supplied by affiliates or related parties of Operator
shall be performed or supplied at competitive rates, pursuant to written agreement, and in accordance with customs and
standards prevailing in the industry.

2. Discharge of Joint Account Obligations: Except as herein otherwise specifically provided, Operator shall promptly pay
and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall
charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in Exhibit "C."
Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits
made and received.

3. Protection from Liens: Operator shall pay, or cause to be paid, as and when they become due and payable, all accounts
of contractors and suppliers and wages and salaries for services rendered or performed, and for materials supplied on, to or in
respect of the Contract Area or any operations for the joint account thereof, and shall keep the Contract Area free from
Article V. OPERATOR

A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR (continued)

Petroleum Negotiators, this issue is addressed and it provides three options. The Operator may be liable for all consequential and punitive damages, may not be liable for such damages or may be liable for only a portion of such damages. The customary form of JOA used in offshore UK operations insulates the Operator from "any consequential loss, including but not limited to inability to produce Petroleum, lost production, or loss of profits." See Taylor, Winsor and Tyne, The Joint Operating Agreement, Longman Group UK Ltd. (1989) for an excellent analysis of the UK form of JOA.

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 wellbore. 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.D.7. requires the Operator to "adequately test all Zones encountered which may reasonably be expected to be capable of producing Oil and Gas in paying quantities as a result of examination of the electric log or any other logs or cores or tests conducted thereunder." This sentence was re-worded to clarify the Operator's obligation to adequately test. Finally, Article VI.C.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

The Operator may resign at any time after providing notice to the Non-Operators. The Operator shall be deemed to have resigned if it "terminates its legal existence, no longer owns an interest hereunder in the Contract Area, or is no longer capable of serving as Operator." It will be an objective fact as to whether an Operator "terminates its legal existence" and this standard will unlikely cause conflict. On the other hand, the third standard of no longer being capable of serving as Operator may well result in protracted litigation as this standard will no doubt be perceived differently by the parties. Neither of these standards are often used. The second standard, "no longer owns an interest in the Contract Area," is used frequently. It is this standard which prohibits a party who is the Operator from passing operator-
ARTICLE V.
OPERATOR

A. Designations 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. In its performance of services hereunder for the Non-Operators, Operator shall be an independent contractor not subject to the control or direction of the Non-Operators except as to the type of operation to be undertaken in accordance with the election procedures contained in this agreement. Operator shall not be deemed, or hold itself out as, the agent of the Non-Operators with authority to bind them to any obligation or liability assumed or incurred by Operator as to any third party. Operator shall conduct its activities under this agreement as a reasonable prudent operator, in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and regulation, but in no event shall it have any 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:

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 only for good cause by the affirmative vote of Non-Operators owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator; such vote shall not be deemed effective until a written notice has been delivered to the Operator by a Non-Operator detailing the alleged default and Operator has failed to cure the default within thirty (30) days from its receipt of the notice or, if the default concerns an operation then being conducted, within forty-eight (48) hours of its receipt of the notice. For purposes hereof, "good cause" shall mean not only gross negligence or willful misconduct but also the material breach of or inability to meet the standards of operation contained in Article V.A. or material failure or inability to perform its obligations under this agreement.

2. Selection of Successor Operator: Upon the resignation or removal of Operator under any provision of this agreement, 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 or is deemed to have resigned fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of the party or 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 or resigned. The former Operator shall promptly deliver to the successor Operator all records and data relating to the operations conducted by the former Operator to the extent such records and data are not already in the possession of the successor operator. Any cost of obtaining or copying the former Operator's records and data shall be charged to the joint account.

3. Effect of Bankruptcy: If Operator becomes insolvent, bankrupt or is placed in receivership, it shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor. If a petition for relief under the federal bankruptcy laws is filed by or against Operator, and the removal of Operator is prevented by the federal bankruptcy court, all Non-Operators and Operator shall comprise an interim operating committee to serve until Operator has elected to reject or assume this agreement pursuant to the Bankruptcy Code, and an election to reject this agreement by Operator as a debtor in possession, or by a trustee in bankruptcy, shall be deemed a resignation as Operator without any action by Non-Operators, except the selection of a successor. During the period of time the operating committee controls operations, all actions shall require the approval of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A." In the event there are only two (2) parties to this agreement, during the period of time the operating committee controls operations, a third party acceptable to Operator, Non-Operator and the federal bankruptcy court shall be selected as a member of the operating committee, and all actions shall require the approval of two (2) members of the operating committee without regard for their interest in the Contract Area based on Exhibit "A."

C. Employees and Contractors:

The number of employees or contractors 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 or contractors shall be the employees or contractors of Operator.

D. Rights and Duties of Operator:

1. Competitive Rates and Use of Affiliates: 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. All work performed or materials supplied by affiliates or related parties of Operator shall be performed or supplied at competitive rates, pursuant to written agreement, and in accordance with customs and standards prevailing in the industry.

2. Discharge of Joint Account Obligations: Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in Exhibit "C."

3. Protection from Liens: Operator shall pay, or cause to be paid, as and when they become due and payable, all accounts of contractors and suppliers and wages and salaries for services rendered or performed, and for materials supplied on, to or in respect of the Contract Area or any operations for the joint account thereof, and shall keep the Contract Area free from...
Article V. OPERATOR

B. RESIGNATION OR REMOVAL OF OPERATOR
AND SELECTION OF SUCCESSOR (continued)

...ship to a purchaser or an assignee. The operatorship is personal to the party and cannot be assigned. When the Operator assigns its interest it "no longer owns an interest in the Contract Area" and it thus has no right to retain or assign operatorship. A successor Operator must be selected pursuant to Article V.B.2.

Occasionally, an Operator will assign all of its interest and still desires to retain operatorship. This result can only be accomplished if all the parties agree to amend the JOA accordingly. Care should be exercised to ensure that promoters do not strike this language. A promoter who is able to have this language stricken and then ultimately divests itself of any interest in the Contract Area, may have an economic interest in earning a profit by operating the project at the expense of the Non-Operators. It is customary that the Operator have an economic interest in the Contract Area. Having said this, there may be occasions where a contract operator is retained because it is efficient to use a third party in a given area to conduct operations.

Due to the contentious nature of the removal issue, the drafters of the 1989 Form only incorporated relatively minor changes. In a prior draft the 1989 Form Revisions Committee proposed two options. One option provided for removal only for good cause. The other option required removal "without cause by the affirmative vote of Non-Operators owning ___% interest." Unfortunately, the 1989 Form does not contain a removal without cause option. A removal without cause option would tend to keep overhead expenses down, give the Non-Operators the ability to replace an ineffectual Operator and would provide the only real solution to removing an Operator who has financial problems before he files for bankruptcy.

The drafters deserve credit for defining "good cause" to mean not only gross negligence or willful misconduct but also the material breach of or inability to meet the standards of operation contained in Article V.A. or material failure or inability to perform its obligations under this agreement. Article V.D.2. requires that the Operator "promptly pay and discharge expenses incurred in the development and operation of the Contract Area . . . ." The Operator by virtue of Article V.D.3. is further required to pay "as and when they become due and payable, all accounts of contractors and suppliers and wages and salaries for services rendered or performed, and for materials supplied . . . and shall keep the Contract Area free from liens and encumbrances . . . ." Moreover, Article VII.D.1. states that if the "Operator is the party in default, the Non-Operators shall have in addition the right, by vote of Non-
ARTICLE V.

OPERATOR

A. Designations 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. In its performance of services hereunder for the Non-Operators, Operator shall be an independent contractor not subject to the control or direction of the Non-Operators except as to the type of operation to be undertaken in accordance with the election procedures contained in this agreement. Operator shall not be deemed, or hold itself out as, the agent of the Non-Operators with authority to bind them to any obligation or liability assumed or incurred by Operator as to any third party. Operator shall conduct its activities under this agreement as a reasonable prudent operator, in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and regulation, but in no event shall it have any 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:

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 for good cause by the affirmative vote of Non-Operators owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator; such vote shall not be deemed effective until a written notice has been delivered to the Operator by a Non-Operator detailing the alleged default and Operator has failed to cure the default within thirty (30) days from its receipt of the notice or, if the default concerns an operation then being conducted, within forty-eight (48) hours of its receipt of the notice. For purposes hereof, "good cause" shall mean not only gross negligence or willful misconduct but also the material breach of or inability to meet the standards of operation contained in Article V.A. or material failure or inability to perform its obligations under this agreement.

2. Selection of Successor Operator: Upon the resignation or removal of Operator under any provision of this agreement, 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 or is deemed to have resigned fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of the party or 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 or resigned. The former Operator shall promptly deliver to the successor Operator all records and data relating to the operations conducted by the former Operator to the extent such records and data are not already in the possession of the successor operator. Any cost of obtaining or copying the former Operator's records and data shall be charged to the joint account.

3. Effect of Bankruptcy: If Operator becomes insolvent, bankrupt or is placed in receivership, it shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor. If a petition for relief under the federal bankruptcy laws is filed by or against Operator, and the removal of Operator is prevented by the federal bankruptcy court, all Non-Operators and Operator shall comprise an interim operating committee to serve until Operator has elected to reject or assume this agreement pursuant to the Bankruptcy Code, and an election to reject this agreement by Operator as a debtor in possession, or by a trustee in bankruptcy, shall be deemed a resignation as Operator without any action by Non-Operators, except the selection of a successor. During the period of time the operating committee controls operations, all actions shall require the approval of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A." In the event there are only two (2) parties to this agreement, during the period of time the operating committee controls operations, a third party acceptable to Operator, Non-Operator and the federal bankruptcy court shall be selected as a member of the operating committee, and all actions shall require the approval of two (2) members of the operating committee without regard for their interest in the Contract Area based on Exhibit "A."

C. Employees and Contractors:

The number of employees or contractors 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 or contractors shall be the employees or contractors of Operator.

D. Rights and Duties of Operator:

1. Competitive Rates and Use of Affiliates: 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. All work performed or materials supplied by affiliates or related parties of Operator shall be performed or supplied at competitive rates, pursuant to written agreement, and in accordance with customs and standards prevailing in the industry.

2. Discharge of Joint Account Obligations: Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in Exhibit "C." Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

3. Protection from Liens: Operator shall pay, or cause to be paid, as and when they become due and payable, all accounts of contractors and suppliers and wages and salaries for services rendered or performed, and for materials supplied on, to or in respect of the Contract Area or any operations for the joint account thereof, and shall keep the Contract Area free from...
Article V. OPERATOR

B. RESIGNATION OR REMOVAL OF OPERATOR
   AND SELECTION OF SUCCESSOR (continued)

Operators owning a majority in interest in the Contract Area after excluding the voting interest of Operator, to appoint a new Operator effective immediately. In the final sentence (Article XV.D.) it is provided that "the failure of any party to this agreement to comply with all of its financial obligations provided herein shall be a material default." An Operator who fails to timely pay its bills may be removed prior to the filing of a bankruptcy petition and prior to the institution of the bankruptcy court's jurisdiction. By so doing, the bankruptcy court should not have the requisite authority to stay or reverse the Operator's removal. For this provision to be effective, however, the Non-Operators must act before the Operator avails itself of the jurisdiction of the bankruptcy court. Inaction may well perpetuate the Operator's position.

A resigning or removed Operator shall give the Non-Operator 90 days to name a successor Operator, unless the successor Operator has been selected and wishes to assume such duties at an earlier date. The court in *Lancaster v. Petroleum Corp. of Delaware*, 491 So.2d 768, *reh. den.* (1986), held that an Operator had breached its duty under the JOA when it threatened to resign unless the parties to the JOA consented to plug and abandon a well that had experienced a blowout or took over the well. The court, in a poorly reasoned decision, imposed damages of $363,693.77 for 8.75% back-in interest in a well that never paid out.

The 1989 Form provides that a successor Operator shall be selected by an affirmative vote of two or more of the parties owning a majority interest. The drafters did address the situation where there are only two parties to the JOA or the Non-Operators do not have in the aggregate sufficient interest to reach a majority. Under these circumstances, the Operator's vote shall be excluded. The 1989 Form now also requires the former Operator to deliver records and data to the successor Operator and any copying costs are to be charged to the joint account.

To protect Non-Operators from the insolvent or bankrupt Operator, a new provision states that if an "Operator becomes insolvent, bankrupt or is placed in receivership it shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor." And if the removal of Operator is prevented by the bankruptcy court, an operating committee (called interim operating committee) comprised of all parties shall operate until the JOA has been accepted or rejected. If there is only one Non-Operator, a third party acceptable to Non-Operator, Operator and the bankruptcy court will be chosen to sit as the swing vote on the
A. Designations and Responsibilities of Operator:

shall be the Operator of the Contract Area, and shall conduct direct and have full control of all operations on the Contract Area as permitted and required by, and within the limits of this agreement. In its performance of services hereunder for the Non-Operators, Operator shall be an independent contractor not subject to the control or direction of the Non-Operators except as to the type of operation to be undertaken in accordance with the election procedures contained in this agreement. Operator shall not be deemed, or hold itself out as, the agent of the Non-Operators with authority to bind them to any obligation or liability assumed or incurred by Operator as to any third party. Operator shall conduct its activities under this agreement as a reasonable prudent operator, in a good and workmanlike manner, with due diligence and dispatch, in accordance with good oilfield practice, and in compliance with applicable law and regulation, but in no event shall it have any 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:

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 only for good cause by the affirmative vote of Non-Operators owning a majority interest based on ownership as shown on Exhibit "A" remaining after excluding the voting interest of Operator; such vote shall not be deemed effective until a written notice has been delivered to the Operator by a Non-Operator detailing the alleged default and Operator has failed to cure the default within thirty (30) days from its receipt of the notice or, if the default concerns an operation then being conducted, within forty-eight (48) hours of its receipt of the notice. For purposes hereof, "good cause" shall mean not only gross negligence or willful misconduct but also the material breach of or inability to meet the standards of operation contained in Article V.A. or material failure or inability to perform its obligations under this agreement.

2. Selection of Successor Operator: Upon the resignation or removal of Operator under any provision of this agreement, 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 or is deemed to have resigned fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of the party or 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 or resigned. The former Operator shall promptly deliver to the successor Operator all records and data relating to the operations conducted by the former Operator to the extent such records and data are not already in the possession of the successor operator. Any cost of obtaining or copying the former Operator's records and data shall be charged to the joint account.

3. Effect of Bankruptcy: If Operator becomes insolvent, bankrupt or is placed in receivership, it shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor. If a petition for relief under the federal bankruptcy laws is filed by or against Operator, and the removal of Operator is prevented by the federal bankruptcy court, all Non-Operators and Operator shall comprise an interim operating committee to serve until Operator has elected to reject or assume this agreement pursuant to the Bankruptcy Code, and an election to reject this agreement by Operator as a debtor in possession, or by a trustee in bankruptcy, shall be deemed a resignation as Operator without any action by Non-Operators, except the selection of a successor. During the period of time the operating committee controls operations, all actions shall require the approval of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A." In the event there are only two (2) parties to this agreement, during the period of time the operating committee controls operations, a third party acceptable to Operator, Non-Operator and the federal bankruptcy court shall be selected as a member of the operating committee, and all actions shall require the approval of two (2) members of the operating committee without regard for their interest in the Contract Area based on Exhibit "A."

C. Employees and Contractors:

The number of employees or contractors 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 or contractors shall be the employees or contractors of Operator.

D. Rights and Duties of Operator:

1. Competitive Rates and Use of Affiliates: 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. All work performed or materials supplied by affiliates or related parties of Operator shall be performed or supplied at competitive rates, pursuant to written agreement, and in accordance with customs and standards prevailing in the industry.

2. Discharge of Joint Account Obligations: Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses incurred in the development and operation of the Contract Area pursuant to this agreement and shall charge each of the parties hereto with their respective proportionate shares upon the expense basis provided in Exhibit "C." Operator shall keep an accurate record of the joint account hereunder, showing expenses incurred and charges and credits made and received.

3. Protection from Liens: Operator shall pay, or cause to be paid, as and when they become due and payable, all accounts of contractors and suppliers and wages and salaries for services rendered or performed, and for materials supplied on, to or in respect of the Contract Area or any operations for the joint account thereof, and shall keep the Contract Area free from
ARTICLE V. OPERATOR

B. RESIGNATION OR REMOVAL OF OPERATOR AND SELECTION OF SUCCESSOR (continued)

operating committee. It will no doubt be extremely difficult and time consuming to select a third party acceptable to the Operator and the Non-Operator. To facilitate the replacement of the Operator (in a two party agreement), a Non-Operator will, of course, always have the ability to consent to the entity chosen by the Operator. This assumes that the bankruptcy court wishes to enforce this provision. This concept is interesting and it may work. On the other hand, bankruptcy courts may view the provision as an incursion into their jurisdiction and declare the provision invalid.

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.

C. EMPLOYEES AND CONTRACTORS

The Operator has discretion to employ as many of its employees and outside contractors as it deems necessary and to determine compensation levels, subject to the standard of care provided for in Article V.A. and its expenditure limitation as provided for in Article VI.D.

D. RIGHTS AND DUTIES OF OPERATOR

The Operator is required to timely pay all expenses and keep the Contract Area free of liens. The Operator shall hold Non-Operators' funds, although the Operator is not to be considered a fiduciary. In Oklahoma, however, the Operator may be held to be a trustee which owes a fiduciary duty to the Non-Operators. See Reserve Oil, Inc. v. Dixon, 711 F.2d 951 (10th Cir. 1983). In In re Mahan & Rowsey, Inc., 817 F.2d 682 (10th Cir. 1987) the court held that the JOA created a "trustee type relationship" which resulted in the creation of a constructive trust over overcharged funds paid by a Non-Operator which were commingled by the Operator. The money in the commingled account did not become part of the bankruptcy estate. However, the court ruled that only the lowest balance in the commingled account is subject to trust pursuit. Overpayments in excess of the lowest balance could be sought as a general creditor.

The Operator is not required to establish an escrow account or a separate account, unless otherwise specifically agreed. (The first generally circulated draft of what has
liens and encumbrances resulting therefrom except for those resulting from a bona fide dispute as to services rendered or materials supplied.

4. Custody of Funds. Operator shall hold for the account of the Non-Operators any funds of the Non-Operators advanced or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the Contract Area, and such funds shall remain the funds of the Non-Operators on whose account they are advanced or paid until used for their intended purpose or otherwise delivered to the Non-Operators or applied toward the payment of debts as provided in Article VII.B. Nothing in this paragraph shall be construed to establish a fiduciary relationship between Operator and Non-Operators for any purpose other than to account for Non-Operator funds as herein specifically provided. Nothing in this paragraph shall require the maintenance by Operator of separate accounts for the funds of Non-Operators unless the parties otherwise specifically agree.

5. Access to Contract Area and Records. Operator shall, except as otherwise provided herein, permit each Non-Operator or its duly authorized representative, at the Non-Operator's sole risk and cost, full and free access at all reasonable times to all operations of every kind and character being conducted for the joint account on the Contract Area and to the records of operations conducted thereon or production therefrom, including Operator's books and records relating thereto. Such access rights shall not be exercised in a manner interfering with Operator's conduct of an operation hereunder and shall not obligate Operator to furnish any geologic or geophysical data of an interpretive nature unless the cost of preparation of such interpretive data was charged to the joint account. Operator will furnish to each Non-Operator upon request copies of any and all reports and information obtained by Operator in connection with production and related items, including, without limitation, meter and chart reports, production purchaser statements, run tickets and monthly gauge reports, but excluding purchase contracts and pricing information to the extent not applicable to the production of the Non-Operator seeking the information. Any audit of Operator's records relating to amounts expended and the appropriateness of such expenditures shall be conducted in accordance with the audit protocol specified in Exhibit "C."

6. Filing and Furnishing Governmental Reports. Operator will file, and upon written request promptly furnish copies to each requesting Non-Operator not in default of its payment obligations, all operational notices, reports or applications required to be filed by local, State, Federal or Indian agencies or authorities having jurisdiction over operations hereunder. Each Non-Operator shall provide to Operator on a timely basis all information necessary to Operator to make such filings.

7. Drilling and Testing Operations. The following provisions shall apply to each well drilled hereunder, including but not limited to the Initial Well:

(a) Operator will promptly advise Non-Operators of the date on which the well is spudded, or the date on which drilling operations are commenced.

(b) Operator will send to Non-Operators such reports, test results and notices regarding the progress of operations on the well as the Non-Operators shall reasonably request, including, but not limited to, daily drilling reports, completion reports, and well logs.

(c) Operator shall adequately test all Zones encountered which may reasonably be expected to be capable of producing Oil and Gas in paying quantities as a result of examination of the electric log or any other logs or cores or tests conducted hereunder.

8. Cost Estimates. Upon request of any Consenting Party, Operator shall furnish estimates of current and cumulative costs incurred for the joint account at reasonable intervals during the conduct of any operation pursuant to this agreement. Operator shall not be held liable for errors in such estimates so long as the estimates are made in good faith.

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

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

ARTICLE VI
DRILLING AND DEVELOPMENT

** ** ** 52
On or before the ______ day of ______, 19____, Operator shall commence the drilling of the Initial Well at the following location:

** ** **

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

The drilling of the Initial Well and the participation therein by all parties is obligatory, subject to Article VI.C.1. as to participation in Completion operations and Article VI.F. as to termination of operations and Article XI as to occurrence of force majeure.

B. Subsequent Operations:

1. Proposed Operations: If any party hereto should desire to drill any well on the Contract Area other than the Initial Well, or if any party should desire to Rework, Sidetrack, Deepen, Recomplete or Plug Back a dry hole or a well no longer capable of producing in paying quantities in which such party has not otherwise relinquished its interest in the proposed objective Zone under this agreement, the party desiring to drill, Rework, Sidetrack, Deepen, Recomplete or Plug Back such a well shall give written notice of the proposed operation to the parties who have not otherwise relinquished their interest in such objective Zone.
Article V. OPERATOR

D. RIGHTS AND DUTIES OF OPERATOR (continued)

become the 1989 Form required that an escrow account be established for the drilling of every well.)

Non-Operators are given greater access to visit the operation site, to review the Operator's books and records and to request production related information. In addition, the Operator is now obligated to: (1) advise the Non-Operators of the date the well is spud or commenced; (2) provide progress reports and test results if requested; (3) adequately test all Zones encountered which may reasonably be expected to be capable of producing Oil and Gas in paying quantities as a result of examination of the electrical log or any other logs or cores or test conducted hereunder"; and (4) furnish to any Consenting Party estimates of current and cumulative costs incurred for the joint account. Operators may object to providing the Non-Operators and especially Non-Consenting Parties with progress reports and test results. It has frequently been contended that Non-Consenting Parties should not get well information. And in specific instances, this provision should be amended to deny or withhold certain technical information from the Non-Consenting Parties. As to financial information, it should be disseminated to both Consenting and Non-Consenting Parties. The Consenting Parties have a right to know the revenues and expenses. Likewise, the Non-Consenting Parties need such financial information to monitor the recoupment account.

Great debate has recently ensued surrounding the issue of how much information should an Operator who is drilling a horizontal well have to disseminate to Non-Operators. Operators of horizontal wells claim, and in many instances possess, information which is patented, patentable or proprietary and valuable. Moreover, an Operator may be subject to certain confidential restrictions contained in drilling contracts or service agreements. Consequently, the Operator may be legally prohibited from disclosing or may not wish to disclose certain information to the Non-Operators. Non-Operators will frequently insist on receiving all information associated with activities they are paying for. This issue should be discussed and appropriate language should be incorporated if the parties wish to modify the Operator's obligation to disseminate information. (See Article XVI.R. for an example.)

These provisions give Non-Operators a far greater ability to satisfy themselves that the operations are being conducted in an appropriate manner. Many of the larger Operators will likely complain that this is overkill and will only lead to additional cost and time delays. If both Operators and Non-Operators act reasonably, this
liens and encumbrances resulting therefrom except for those resulting from a bona fide dispute as to services rendered or
materials supplied.
4. Custody of Funds. Operator shall hold for the account of the Non-Operators any funds of the Non-Operators advanced
or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the
Contract Area, and such funds shall remain the funds of the Non-Operators on whose account they are advanced or paid until
used for their intended purpose or otherwise delivered to the Non-Operators or applied toward the payment of debts as
provided in Article VII.B. Nothing in this paragraph shall be construed to establish a fiduciary relationship between Operator
and Non-Operators for any purpose other than to account for Non-Operator funds as herein specifically provided. Nothing in
this paragraph shall require the maintenance by Operator of separate accounts for the funds of Non-Operators unless the
parties otherwise specifically agree.
5. Access to Contract Area and Records. Operator shall, except as otherwise provided herein, permit each Non-Operator
or its duly authorized representative, at the Non-Operator's sole risk and cost, full and free access at all reasonable times to
all operations of every kind and character being conducted for the joint account on the Contract Area and to the records of
operations conducted thereon or production therefrom, including Operator's books and records relating thereto. Such access
shall not be exercised in a manner interfering with Operator's conduct of an operation hereunder and shall not obligate
Operator to furnish any geologic or geophysical data of an interpretive nature unless the cost of preparation of such
interpretive data was charged to the joint account. Operator will furnish to each Non-Operator upon request copies of any
and all reports and information obtained by Operator in connection with production and related items, including, without
limitation, meter and chart reports, production purchaser statements, run tickets and monthly gauge reports, but excluding
purchase contracts and pricing information to the extent not applicable to the production of the Non-Operator seeking the
information. Any audit of Operator's records relating to amounts expended and the appropriateness of such expenditures
shall be conducted in accordance with the audit protocol specified in Exhibit "C."
6. Filing and Furnishing Governmental Reports. Operator will file, and upon written request promptly furnish copies to
each requesting Non-Operator not in default of its payment obligations, all operational notices, reports or applications
required to be filed by local, State, Federal or Indian agencies or authorities having jurisdiction over operations hereunder.
Each Non-Operator shall provide to Operator on a timely basis all information necessary to Operator to make such filings.
7. Drilling and Testing Operations. The following provisions shall apply to each well drilled hereunder, including but not
limited to the Initial Well:
   (a) Operator will promptly advise Non-Operators of the date on which the well is spudded, or the date on which
drilling operations are commenced.
   (b) Operator will send to Non-Operators such reports, test results and notices regarding the progress of operations on the well
as the Non-Operators shall reasonably request, including, but not limited to, daily drilling reports, completion reports, and well logs.
   (c) Operator shall adequately test all Zones encountered which may reasonably be expected to be capable of producing
Oil and Gas in paying quantities as a result of examination of the electric log or any other logs or cores or tests conducted
hereunder.
incurred for the joint account at reasonable intervals during the conduct of any operation pursuant to this agreement.
Operator shall not be held liable for errors in such estimates so long as the estimates are made in good faith.
9. Insurance. At all times while operations are conducted hereunder, Operator shall comply with the workers
compensation law of the state where the operations are being conducted; provided, however, that Operator may be a self-
insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall
be as provided in Exhibit "C." Operator shall also carry or provide insurance for the benefit of the joint account of the parties
as outlined in Exhibit "D" attached hereto and made a part hereof. Operator shall require all contractors engaged in work on
or for the Contract Area to comply with the workers compensation law of the state where the operations are being conducted
and to maintain such other insurance as Operator may require.
In the event automobile liability insurance is specified in said Exhibit "D," or subsequently receives the approval of the
parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's automotive
equipment.

ARTICLE VI
DRILLING AND DEVELOPMENT

A. Initial Well:

** * * * **
On or before the _______ day of _________, 19_____, Operator shall commence the drilling of the Initial
Well at the following location:

** * * * **

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

The drilling of the Initial Well and the participation therein by all parties is obligatory, subject to Article VI.C.1. as to participation
in Completion operations and Article VI.F. as to termination of operations and Article XI as to occurrence of force majeure.
B. Subsequent Operations:
1. Proposed Operations: If any party hereto should desire to drill any well on the Contract Area other than the Initial Well, or
if any party should desire to Rework, Sidetrack, Deepen, Recomplete or Plug Back a dry hole or a well no longer capable of
producing in paying quantities in which such party has not otherwise relinquished its interest in the proposed objective Zone under
this agreement, the party desiring to drill, Rework, Sidetrack, Deepen, Recomplete or Plug Back such a well shall give written
notice of the proposed operation to the parties who have not otherwise relinquished their interest in such objective Zone
Article V. OPERATOR

D. RIGHTS AND DUTIES OF OPERATOR (continued)

process should work smoothly. The process can, however, be abused. Most interesting is the provision that requires Operators to test all Zones which may reasonably be expected to be capable of production. This obligation or requirement applies to the Initial Well and all future wells. The 1982 Form does not clearly address this issue with regard to the Initial Well and does not at all address this issue with regard to Subsequent Operations, and this ambiguity has led to controversies. Although this controversy has been clarified in the 1989 Form, does the Operator have to test Zones which he does not intend to initially produce because such production is inconsistent with state regulations which prohibit commingling or dual production?

There may be fiduciary type duties that arise with regard to information acquired and paid for pursuant to the JOA. In Rankin v. Naftalis, 557 S.W.2d 940 (Tex. 1977) and Foley v. Phillips, 508 P.2d 975 (Kan. 1973) these obligations were limited to the lands covered by the JOA. While in Frankfort Oil Co. v. W.F. Snakard, 279 F.2d 436 (10th Cir. 1960) and Tenneco Oil Co. v. Bogert, 630 F. Supp. 961 (W.D. Okla. 1986) the obligations are limited to the terms of the JOA.

Article VI. DRILLING AND DEVELOPMENTS

A. INITIAL WELL

Be careful when completing this provision to specify a realistic date for commencing operations on the first well. Note that a new sentence has been added which clearly states that the drilling of the Initial Well is obligatory. To avoid making the drilling of the Initial Well obligatory, 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 "obligatory" could be replaced by the word "optional." 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 operations by a specified date, the court in Argos Resources, Inc. v. May Petroleum Inc., 693 S.W.2d 663 (Tex. App. 1985), 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."
liens and encumbrances resulting therefrom except for those resulting from a bona fide dispute as to services rendered or materials supplied.

4. Custody of Funds. Operator shall hold for the account of the Non-Operators any funds of the Non-Operators advanced or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the Contract Area, and such funds shall remain the funds of the Non-Operators on whose account they are advanced or paid until used for their intended purpose or otherwise delivered to the Non-Operators or applied toward the payment of debts as provided in Article VII.B. Nothing in this paragraph shall be construed to establish a fiduciary relationship between Operator and Non-Operators for any purpose other than to account for Non-Operator funds as herein specifically provided. Nothing in this paragraph shall require the maintenance by Operator of separate accounts for the funds of Non-Operators unless the parties otherwise specifically agree.

5. Access to Contract Area and Records. Operator shall, except as otherwise provided herein, permit each Non-Operator or its duly authorized representative, at the Non-Operator's sole risk and cost, full and free access at all reasonable times to all operations of every kind and character being conducted for the joint account on the Contract Area and to the records of operations conducted thereon or production therefrom, including Operator's books and records relating thereto. Such access shall not be exercised in a manner interfering with Operator's conduct of an operation hereunder and shall not obligate Operator to furnish any geologic or geophysical data of an interpretive nature unless the cost of preparation of such interpretive data was charged to the joint account. Operator shall furnish to each Non-Operator upon request copies of any and all reports and information obtained by Operator in connection with production and related items, including, without limitation, meter and chart reports, production purchaser statements, run tickets and monthly gauge reports, but excluding purchase contracts and pricing information to the extent not applicable to the production of the Non-Operator seeking the information. Any audit of Operator's records relating to amounts expended and the appropriateness of such expenditures shall be conducted in accordance with the audit protocol specified in Exhibit "C."

6. Filing and Furnishing Governmental Reports. Operator will file, and upon written request promptly furnish copies to each requesting Non-Operator in default of its payment obligations, all operational notices, reports or applications required to be filed by local, State, Federal or Indian agencies or authorities having jurisdiction over operations hereunder. Each Non-Operator shall provide to Operator a timely basis all information necessary to Operator to make such filings.

7. Drilling and Testing Operations. The following provisions shall apply to each well drilled hereunder, including but not limited to the Initial Well:

(a) Operator will promptly advise Non-Operators of the date on which the well is spudded, or the date on which drilling operations are commenced.

(b) Operator will send to Non-Operators such reports, test results and notices regarding the progress of operations on the well as the Non-Operators shall reasonably request, including, but not limited to, daily drilling reports, completion reports, and well logs.

(c) Operator shall adequately test all Zones encountered which may reasonably be expected to be capable of producing Oil and Gas in paying quantities as a result of examination of the electric log or any other logs or cores or tests conducted hereunder.

8. Cost Estimates. Upon request of any Consenting Party, Operator shall furnish estimates of current and cumulative costs incurred for the joint account at reasonable intervals during the conduct of any operation pursuant to this agreement. Operator shall not be held liable for errors in such estimates so long as the estimates are made in good faith.

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

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

ARTICLE VI
DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the [date] day of [month], 19__, Operator shall commence the drilling of the Initial Well at the following location:

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

The drilling of the Initial Well and the participation therein by all parties is obligatory, subject to Article VI.C.1. as to participation in Completion operations and Article VI.F. as to termination of operations and Article XI as to occurrence of force majeure.

B. Subsequent Operations:

1. Proposed Operations: If any party hereto should desire to drill any well on the Contract Area other than the Initial Well, or if any party should desire to Rework, Sidetrack, Deepen, Recomplete or Plug Back a dry hole or a well no longer capable of producing in paying quantities in which such party has not otherwise relinquished its interest in the proposed objective Zone under this agreement, the party desiring to drill, Rework, Sidetrack, Deepen, Recomplete or Plug Back such a well shall give written notice of the proposed operation to the parties who have not otherwise relinquished their interest in such objective Zone.
Article VI. DRILLING AND DEVELOPMENTS

A. INITIAL WELL (continued)

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 the Operator can only seek one 30 day extension.

One problem not cured by the 1989 Form occurs where the Operator does not want a well drilled and it fails to commence operations within the 90 plus 30 day period. Unless a Non-Operator can prove a violation of Article V.A., the Operator may be able to delay drilling with impunity. This situation occurs where an Operator likes a certain prospect, but does not currently have the money to drill the well. When a proposal to drill is made, the Operator rather than go non-consent, consents to the well. Since the Operator does not have the current dollars to drill the well, it fails to comply with the 90 plus 30 day period of Article VI.B.1. The drilling proposal must be resubmitted, and the Operator hopes that it will have the requisite money to drill the prospect in the future. This action clearly violates the spirit of Article V.A., and if such intent can be proven should result in the imposition of liability and the removal of the Operator.
4. Custody of Funds. Operator shall hold for the account of the Non-Operators any funds of the Non-Operators advanced or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the Contract Area, and such funds shall remain the funds of the Non-Operators on whose account they are advanced or paid until used for their intended purpose or otherwise delivered to the Non-Operators or applied toward the payment of debts as provided in Article VII.B. Nothing in this paragraph shall be construed to establish a fiduciary relationship between Operator and Non-Operators for any purpose other than to account for Non-Operator funds as herein specifically provided. Nothing in this paragraph shall require the maintenance of Operator of separate accounts for the funds of Non-Operators unless the parties otherwise specifically agree.

5. Access to Contract Area and Records. Operator shall, except as otherwise provided herein, permit each Non-Operator or its duly authorized representative, at the Non-Operator's sole risk and cost, full and free access at all reasonable times to all operations of every kind and character being conducted for the joint account on the Contract Area and to the records of operations conducted thereon or production therefrom, including Operator's books and records relating thereto. Such access shall not be exercised in a manner interfering with Operator's conduct of an operation hereunder and shall not obligate Operator to furnish any geologic or geophysical data of an interpretive nature unless the cost of preparation of such data was charged to the joint account. Operator will furnish to each Non-Operator upon request copies of any and all reports and information obtained by Operator in connection with production and related items, including, without limitation, meter and chart reports, production purchaser statements, run tickets and monthly gauge reports, but excluding purchase contracts and pricing information to the extent not applicable to the production of the Non-Operator seeking the information. Any audit of Operator's records relating to amounts expended and the appropriateness of such expenditures shall be conducted in accordance with the audit protocol specified in Exhibit "C."

6. Filing and Furnishing Governmental Reports. Operator will file, and upon written request promptly furnish copies to each requesting Non-Operator not in default of its payment obligations, all operational notices, reports or applications required to be filed by local, State, Federal or Indian agencies or authorities having jurisdiction over operations hereunder. Each Non-Operator shall provide to Operator a timely basis all information necessary to Operator to make such filings.

7. Drilling and Testing Operations. The following provisions shall apply to each well drilled hereunder, including but not limited to the Initial Well:

(a) Operator will promptly advise Non-Operators of the date on which the well is spudded, or the date on which drilling operations are commenced.

(b) Operator will send to Non-Operators such reports, test results and notices regarding the progress of operations on the well as the Non-Operators shall reasonably request, including, but not limited to, daily drilling reports, completion reports, and well logs.

(c) Operator shall adequately test all Zones encountered which may reasonably be expected to be capable of producing Oil and Gas in paying quantities as a result of examination of the electric log or any other logs or cores or tests conducted hereunder.

8. Cost Estimates. Upon request of any Consenting Party, Operator shall furnish estimates of current and cumulative costs incurred for the joint account at reasonable intervals during the conduct of any operation pursuant to this agreement. Operator shall not be held liable for errors in such estimates so long as the estimates are made in good faith.

9. Insurance. At all times while operations are conducted hereunder, Operator shall comply with the workers compensation law of the state where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be as provided in Exhibit "C."

Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D" attached hereto and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the workers compensation law of the state where the operations are being conducted and to maintain such other insurance as Operator may require.

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

ARTICLE VI

A. Initial Well

** ** On or before the ______ day of __________, 19____, Operator shall commence the drilling of the Initial Well at the following location:

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

The drilling of the Initial Well and the participation therein by all parties is obligatory, subject to Article VI.C.1. as to participation in Completion operations and Article VI.F. as to termination of operations and Article XI as to occurrence of force majeure.

B. Subsequent Operations:

1. Proposed Operations: If any party hereto should desire to drill any well on the Contract Area other than the Initial Well, or if any party should desire to Rework, Sidetrack, Deepen, Recomplete or Plug Back a dry hole or a well no longer capable of producing in paying quantities in which such party has not otherwise relinquished its interest in the proposed objective Zone under this agreement, the party desiring to drill, Rework, Sidetrack, Deepen, Recomplete or Plug Back such a well shall give written notice of the proposed operation to the parties who have not otherwise relinquished their interest in such objective Zone

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Article VI. DRILLING AND DEVELOPMENTS

A. INITIAL WELL (continued)

Describe the exact location of the well. Finally, when completing the blank of lines 61 to 66, be sure to specify a depth in feet or a particular formation, whichever is the lesser depth. The 1989 Form unfortunately does not address the drilling of horizontal wells. When the Initial Well (Article VI.A.) is to be drilled as a horizontal well, the description of the test well should be carefully worded. For horizontal wells it is necessary to consider both the vertical depth and the horizontal distance of the well. Because horizontal technology is in the early stages of its development, horizontal wells are expensive and risky. It is often difficult to predict with precision the exact horizontal distance a well will be able to be drilled. Therefore, Operators should be reticent about committing to drill to a specified horizontal distance. Parties who, because of farmin agreements, need to reach specific horizontal distances need to ensure themselves that the inserted language is consistent with the farmin agreement so as to enable them to earn under their farmin agreement.

The following alternative wording is proposed for insertion to the blank space in Article VI.A.:

1. "... to a total vertical depth of ______ feet or a depth sufficient to penetrate the __________ formation, whichever is the lesser, and to a targeted horizontal distance sufficient in Operator's opinion to test the __________ formation."

2. "... to a total vertical depth of ______ feet or to a depth sufficient to penetrate the __________ formation, whichever is the lesser, and to a targeted horizontal distance of at least ______ feet."

3. "... to a total vertical depth sufficient to penetrate the __________ formation and a total targeted measured distance, from the point the well is spud to the bottom hole location of ______ feet."

Alternative 1 gives the Operator flexibility and discretion on how far a horizontal well need be drilled. Alternative 2 ensures a Non-Operator that the horizontal well will be drilled to a specified distance. This could be important if the Non-Operator has earned requirements pursuant to a farmout or exploration agreement. Alternative 3 may satisfy the same concerns involved with Alternative 2. A total target measured distance is the measured distance from the surface where the well is spud to the end of the drainhole.
liens and encumbrances resulting therefrom except for those resulting from a bona fide dispute as to services rendered or
materials supplied.

4. Custody of Funds. Operator shall hold for the account of the Non-Operators any funds of the Non-Operators advanced
or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the
Contract Area, and such funds shall remain the funds of the Non-Operators on whose account they are advanced or paid until
used for their intended purpose or otherwise delivered to the Non-Operators or applied toward the payment of debts as
provided in Article VII.B. Nothing in this paragraph shall be construed to establish a fiduciary relationship between Operator
and Non-Operators for any purpose other than to account for Non-Operator funds as herein specifically provided. Nothing in
this paragraph shall require the maintenance by Operator of separate accounts for the funds of Non-Operators unless the
parties otherwise specifically agree.

5. Access to Contract Area and Records. Operator shall, except as otherwise provided herein, permit each Non-Operator
or its duly authorized representative, at the Non-Operator's sole risk and cost, full and free access at all reasonable times to
all operations of every kind and character being conducted for the joint account on the Contract Area and to the records of
operations conducted thereon or production therefrom, including Operator's books and records relating thereto. Such access
shall be exercised in a manner interfering with Operator's conduct of an operation hereunder and shall not obligate
Operator to furnish any geologic or geophysical data of an interpretive nature unless the cost of preparation of such
interpretive data was charged to the joint account. Operator will furnish to each Non-Operator upon request copies of any
and all reports and information obtained by Operator in connection with production and related items, including, without
limitation, meter and chart reports, production purchaser statements, run tickets and monthly gauge reports, but excluding
purchase contracts and pricing information to the extent not applicable to the production of the Non-Operator seeking the
information. Any audit of Operator's records relating to amounts expended and the appropriateness of such expenditures
shall be conducted in accordance with the audit protocol specified in Exhibit "C."

6. Filing and Furnishing Governmental Reports. Operator will file, and upon written request promptly furnish copies to
each requesting Non-Operator not in default of its payment obligations, all operational notices, reports or applications
required to be filed by local, State, Federal or Indian agencies or authorities having jurisdiction over operations hereunder.
Each Non-Operator shall provide to Operator on a timely basis all information necessary to Operator to make such filings.

7. Drilling and Testing Operations. The following provisions shall apply to each well drilled hereunder, including but not
limited to the Initial Well:

   (a) Operator will promptly advise Non-Operators of the date on which the well is spudded, or the date on which
drilling operations are commenced.

   (b) Operator will send to Non-Operators such reports, test results and notices regarding the progress of operations on the well
as the Non-Operators shall reasonably request, including, but not limited to, daily drilling reports, completion reports, and well logs.

   (c) Operator shall adequately test all Zones encountered which may reasonably be expected to be capable of producing
Oil and Gas in paying quantities as a result of examination of the electric log or any other logs or cores or tests conducted
hereunder.

incurred for the joint account at reasonable intervals during the conduct of any operation pursuant to this agreement.
Operator shall not be held liable for errors in such estimates so long as the estimates are made in good faith.

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

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

ARTICLE VI
DRILLING AND DEVELOPMENT

A. Initial Well:

* * * *

On or before the day of , 19 , Operator shall commence the drilling of the Initial
Well at the following location:

* * * *

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

The drilling of the Initial Well and the participation therein by all parties is obligatory, subject to Article VI.C.1. as to participation
in Completion operations and Article VI.F. as to termination of operations and Article XI as to occurrence of force majeure.

B. Subsequent Operations:

1. Proposed Operations: If any party hereto should desire to drill any well on the Contract Area other than the Initial Well, or
if any party should desire to Rework, Sidetrack, Deepen, Recomplete or Plug Back a dry hole or a well no longer capable of
producing in paying quantities in which such party has not otherwise relinquished its interest in the proposed objective Zone under
this agreement, the party desiring to drill, Rework, Sidetrack, Deepen, Recomplete or Plug Back such a well shall give written
notice of the proposed operation to the parties who have not otherwise relinquished their interest in such objective Zone
Article VI. DRILLING AND DEVELOPMENTS

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.C.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).

Nothing in this Article restricts the number of wells that can be proposed. A party could conceivably propose the drilling of 20 or more wells. The only limitation is that the well must 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 XVI.L. for an example.)

The 1989 language clarifies the requisite processes and procedures under the subsequent operations provision. In this regard, an additional sentence has been added which states that those "parties that did not participate in the drilling of a well for which a proposal to Deepen or Sidetrack is made hereunder shall, if such parties desire to participate in the proposed Deepening or Sidetracking operation, reimburse the Drilling Parties . . ." for their drilling expenses. This addition clarifies the unresolved question of whether a Non-Consenting Party can participate in the Deepening or Side-tracking operation if it did not participate in the drilling of the well. The 1982 Form does not address this question and numerous controversies
4. Custody of Funds. Operator shall hold for the account of the Non-Operators any funds of the Non-Operators advanced or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the Contract Area, and such funds shall remain the funds of the Non-Operators on whose account they are advanced or paid until used for their intended purpose or otherwise delivered to the Non-Operators or applied toward the payment of debts as provided in Article VII.B. Nothing in this paragraph shall be construed to establish a fiduciary relationship between Operator and Non-Operators for any purpose other than to account for Non-Operator funds as herein specifically provided. Nothing in this paragraph shall require the maintenance by Operator of separate accounts for the funds of Non-Operators unless the parties otherwise specifically agree.

5. Access to Contract Area and Records. Operator shall, except as otherwise provided herein, permit each Non-Operator or its duly authorized representative, at the Non-Operator's sole risk and cost, full and free access at all reasonable times to all operations of every kind and character being conducted for the joint account on the Contract Area and to the records of operations conducted thereon or production therefrom, including Operator's books and records relating thereto. Such access rights shall not be exercised in a manner interfering with Operator's conduct of an operation hereunder and shall not obligate Operator to furnish any geologic or geophysical data of an interpretive nature unless the cost of preparation of such interpretive data was charged to the joint account. Operator will furnish to each Non-Operator upon request copies of any and all reports and information obtained by Operator in connection with production and related items, including, without limitation, meter and chart reports, production purchaser statements, run tickets and monthly gauge reports, but excluding purchase contracts and pricing information to the extent not applicable to the production of the Non-Operator seeking the information. Any audit of Operator's records relating to amounts expended and the appropriateness of such expenditures shall be conducted in accordance with the audit protocol specified in Exhibit "C."

6. Filing and Furnishing Governmental Reports. Operator will file, and upon written request promptly furnish copies to each requesting Non-Operator not in default of its payment obligations, all operational notices, reports or applications required to be filed by local, State, Federal or Indian agencies or authorities having jurisdiction over operations hereunder. Each Non-Operator shall provide to Operator on a timely basis all information necessary to Operator to make such filings.

7. Drilling and Testing Operations. The following provisions shall apply to each well drilled hereunder, including but not limited to the Initial Well:

(a) Operator will promptly advise Non-Operators of the date on which the well is spudded, or the date on which drilling operations are commenced.

(b) Operator will send to Non-Operators such reports, test results and notices regarding the progress of operations on the well as the Non-Operators shall reasonably request, including, but not limited to, daily drilling reports, completion reports, and well logs.

(c) Operator shall adequately test all Zones encountered which may reasonably be expected to be capable of producing Oil and Gas in paying quantities as a result of examination of the electric log or any other logs or cores or tests conducted hereunder.

8. Cost Estimates. Upon request of any Consenting Party, Operator shall furnish estimates of current and cumulative costs incurred for the joint account at reasonable intervals during the conduct of any operation pursuant to this agreement. Operator shall not be held liable for errors in such estimates so long as the estimates are made in good faith.

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

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

ARTICLE VI
DRILLING AND DEVELOPMENT

A. Initial Well:

** On or before the_______ day of_______, 19____, Operator shall commence the drilling of the Initial Well at the following location:


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


The drilling of the Initial Well and the participation therein by all parties is obligatory, subject to Article VI.C.1. as to participation in Completion operations and Article VI.F. as to termination of operations and Article XI as to occurrence of force majeure.

B. Subsequent Operations:

1. Proposed Operations: If any party hereto should desire to drill any well on the Contract Area other than the Initial Well, or if any party should desire to Rework, Sidetrack, Deepen, Recomplete or Plug Back a dry hole or a well no longer capable of producing in paying quantities in which such party has not otherwise relinquished its interest in the proposed objective Zone under this agreement, the party desiring to drill, Rework, Sidetrack, Deepen, Recomplete or Plug Back such a well shall give written notice of the proposed operation to the parties who have not otherwise relinquished their interest in such objective Zone.
Article VI. DRILLING AND DEVELOPMENTS

B. SUBSEQUENT OPERATIONS (continued)

have followed. Companies may not like the result of this provision, but at least the issue has been addressed. If the parties to the JOA agree, the provision can, of course, be revised to provide for either the payment of a penalty or the denial of the ability to participate in a Deepening or Sidetracking, under certain circumstances.

Although the early drafts of the 1989 Form generally decreased the time periods for responding to proposals by replacing the term "exclusive of Saturday, Sunday and legal holidays" with "inclusive of Saturday, Sunday and legal holidays," this Form continues to use the word "exclusive." I believe this is a mistake. To be competitive and viable U.S. industry must work harder and smarter. With the advent of telecommunications equipment, computers, paging systems and the like, such contractually required communications require less time than in the past. Our industry squanders too much money on stand-by time. Decision-makers should take a break from watching football or cutting their grass and make themselves available to make the necessary decisions. If it were their money, you better believe they would take a couple of hours from their free time to make the required decision.

The 1989 Form does not address the Non-Consenting Parties liability for a well that causes environmental damage where the well fails to produce enough to let the Consenting Parties recoup their expenses plus the associated penalties. Is a Non-Consenting Party responsible, under the JOA, for its share of environmental damages when recoupment of expenses plus the associated penalties has not occurred? Under the Texas Railroad Commission rules, a Non-Consenting Party is responsible for plugging and abandoning a well, even if the well has yet to reach recoupment of expenses plus associated penalties. *Railroad Commission v. Olin Corp.*, 690 S.W.2d, 628 (Tex. Civ. App.), writ ref'd n.r.e. per curiam, 701 S.W.2d 641 (Tex. 1985). That is, even if the Non-Consenting Party's interest has been "temporarily" relinquished to the Consenting Parties, the parties who "temporarily" relinquished their interest are still liable. The Texas Railroad Commission contends that because the Non-Consenting Party has an economic interest in the well, it should pay to plug and abandon the well. The court held that the ownership of even a future interest is part of the working interest, thus subjecting the Non-Consenting Parties to liability for plugging and abandonment. The ownership of a future interest is inconsistent with the concept that the working interest has been "temporarily" relinquished until recoupment has accrued. Perhaps the court was influenced by the fact that during the recoupment period the Non-Consenting Parties still have the right to receive certain information, to elect to review or surrender leases, and to vote to replace the Operator. Moreover, the Non-
liens and encumbrances resulting therefrom except for those resulting from a bona fide dispute as to services rendered or materials supplied.

4. Custody of Funds. Operator shall hold for the account of the Non-Operators any funds of the Non-Operators advanced or paid to the Operator, either for the conduct of operations hereunder or as a result of the sale of production from the Contract Area, and such funds shall remain the funds of the Non-Operators on whose account they are advanced or paid until used for their intended purpose or otherwise delivered to the Non-Operators or applied toward the payment of debts as provided in Article VII.B. Nothing in this paragraph shall be construed to establish a fiduciary relationship between Operator and Non-Operators for any purpose other than to account for Non-Operator funds as herein specifically provided. Nothing in this paragraph shall require the maintenance of Operator of separate accounts for the funds of Non-Operators unless the parties otherwise specifically agree.

5. Access to Contract Area and Records. Operator shall, except as otherwise provided herein, permit each Non-Operator or its duly authorized representative, at the Non-Operator's sole risk and cost, full and free access at all reasonable times to all operations of every kind and character being conducted for the joint account on the Contract Area and to the records of operations conducted thereon or production therefrom, including Operator's books and records relating thereto. Such access rights shall not be exercised in a manner interfering with Operator's conduct of an operation hereunder and shall not obligate Operator to furnish any geologic or geophysical data of an interpretive nature unless the cost of preparation of such interpretive data was charged to the joint account. Operator will furnish to each Non-Operator upon request copies of any and all reports and information obtained by Operator in connection with production and related items, including, without limitation, meter and chart reports, production purchaser statements, run tickets and monthly gauge reports, but excluding purchase contracts and pricing information to the extent not applicable to the production of the Non-Operator seeking the information. Any audit of Operator's records relating to amounts expended and the appropriateness of such expenditures shall be conducted in accordance with the audit protocol specified in Exhibit "C."

6. Filing and Furnishing Governmental Reports. Operator will file, and upon written request promptly furnish copies to each requesting Non-Operator not in default of its payment obligations, all operational notices, reports or applications required to be filed by local, State, Federal or Indian agencies or authorities having jurisdiction over operations hereunder. Each Non-Operator shall provide to Operator on a timely basis all information necessary to Operator to make such filings.

7. Drilling and Testing Operations. The following provisions shall apply to each well drilled hereunder, including but not limited to the Initial Well:

(a) Operator will promptly advise Non-Operators of the date on which the well is spudded, or the date on which drilling operations are commenced.

(b) Operator will send to Non-Operators such reports, test results and notices regarding the progress of operations on the well as the Non-Operators shall reasonably request, including, but not limited to, daily drilling reports, completion reports, and well logs.

(c) Operator shall adequately test all Zones encountered which may reasonably be expected to be capable of producing Oil and Gas in paying quantities as a result of examination of the electric log or any other logs or cores or tests conducted hereunder.

8. Cost Estimates. Upon request of any Consenting Party, Operator shall furnish estimates of current and cumulative costs incurred for the joint account at reasonable intervals during the conduct of any operation pursuant to this agreement. Operator shall not be held liable for errors in such estimates so long as the estimates are made in good faith.

9. Insurance. At all times while operations are conducted hereunder, Operator shall comply with the workers compensation law of the state where the operations are being conducted; provided, however, that Operator may be a self-insurer for liability under said compensation laws in which event the only charge that shall be made to the joint account shall be as provided in Exhibit "C."

Operator shall also carry or provide insurance for the benefit of the joint account of the parties as outlined in Exhibit "D" attached hereto and made a part hereof. Operator shall require all contractors engaged in work on or for the Contract Area to comply with the workers compensation law of the state where the operations are being conducted and to maintain such other insurance as Operator may require.

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

ARTICLE VI

DRILLING AND DEVELOPMENT

A. Initial Well:

On or before the _________ day of ____________, 19___, Operator shall commence the drilling of the Initial Well at the following location:

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

The drilling of the Initial Well and the participation therein by all parties is obligatory, subject to Article VI.C.1. as to participation in Completion operations and Article VI.F. as to termination of operations and Article XI as to occurrence of force majeure.

B. Subsequent Operations:

1. Proposed Operations: If any party hereto should desire to drill any well on the Contract Area other than the Initial Well, or if any party should desire to Rework, Sidetrack, Deepen, Recomplete or Plug Back a dry hole or a well no longer capable of producing in paying quantities in which such party has not otherwise relinquished its interest in the proposed objective Zone under this agreement, the party desiring to drill, Rework, Sidetrack, Deepen, Recomplete or Plug Back such a well shall give written notice of the proposed operation to the parties who have not otherwise relinquished their interest in such objective Zone
Article VI. DRILLING AND DEVELOPMENTS

B. SUBSEQUENT OPERATIONS (continued)

Consenting Party still owns a property interest and has obligations to its lessor. Does it seem equitable to impose environmental obligations and liabilities on a party who elects not to participate in the drilling of a well? Appropriate language could be inserted to provide that only those parties currently owning an interest in the well or sharing in production should be liable for any environmental damage caused during the period of production. Under certain circumstances, indemnities will also be necessary. Alternatively, in appropriate circumstances a Non-Consenting Party should consider selling its interest to a party who can assume any and all future liabilities.

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, it 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% 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; 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, which 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, although a figure above 100% does compensate for the time value of funds expended. The counter-veiling argument is that at payout the surface equipment is used and Non-Consenting Parties should not have to pay a penalty or premium for such used and depreciated equipment. The 300% figure which is directly related to the assumption of risk is occasionally increased to 500% and in rare situations, it has
under this agreement and to all other parties in the case of a proposal for Sidetracking or Deepening, specifying the work to be performed, the location, proposed depth, objective Zone and the estimated cost of the operation. The parties to whom such a notice is delivered shall have thirty (30) days after receipt of the notice within which to notify the party proposing to do the work whether they elect to participate in the cost of the proposed operation. If a drilling rig is on location, notice of a proposal to Rework, Sidetrack, Recomplete, Plug Back or Deepen may be given by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday, Sunday and legal holidays. Failure of a party to whom such notice is delivered to reply within the period above fixed shall constitute an election by the party not to participate in the cost of the proposed operation. Any proposal by a party to conduct an operation conflicting with the operation initially proposed shall be delivered to all parties within the time and in the manner provided in Article VI.B.6.

If all parties to whom such notice is delivered elect to participate in such a proposed operation, the parties shall be contractually committed to participate therein provided such operations are commenced within the time period hereafter set forth, and Operator shall, no later than ninety (90) days after expiration of the notice period of thirty (30) days (or as promptly as practicable 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 operation and thereafter complete it with due diligence at the risk and expense of the parties participating therein; provided, however, said commencement date may be extended upon written notice of same by Operator to the other parties, 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 permits from governmental authorities, surface rights (including rights-of-way) or appropriate drilling equipment, or to complete title examination or curative matter required for title approval or acceptance. If the actual operation has not been commenced within the time provided (including any extension thereof as specifically permitted herein or in the force majeure provisions of Article XI) and if any party hereto still desires to conduct said operation, written notice proposing same must be resubmitted to the other parties in accordance herewith as if no prior proposal had been made. Those parties that did not participate in the drilling of a well for which a proposal to Deepen or Sidetrack is made hereunder shall, if such parties desire to participate in the proposed Deepening or Sidetracking operation, reimburse the Drilling Parties in accordance with Article VI.B.4. in the event of a Deepening operation and in accordance with Article VI.B.5 in the event of a Sidetracking operation.

2. Operations by Less Than All Parties.

(a) Determination of Participation. If any party to whom such notice is delivered as provided in Article VI.B.1 or VI.C.1. (Option 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 giving the notice and such other parties as shall elect to participate in the operation shall, no later than ninety (90) days after the expiration of the notice period of thirty (30) days (or as promptly as practicable 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 operation and complete it with due diligence. Operator shall perform all work for the amount 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: (i) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (ii) designate one of the Consenting Parties as Operator to perform such work. The rights and duties granted to and imposed upon the Operator under this agreement are granted to and imposed upon the party designated as Operator for an operation in which the original Operator is a Non-Consenting Party. Consenting Parties, when conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms and conditions of this agreement.

If less than all parties approve any proposed operation, the proposing party, immediately after the expiration of the applicable notice period, shall advise all 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 (exclusive of Saturday, Sunday and legal holidays) after delivery of such notice, shall advise the proposing party of its desire to (i) limit participation to such party's interest as shown on Exhibit "A" or (ii) carry only its proportionate part (determined by dividing such party's interest in the Contract Area by the interests of all Consenting Parties in the Contract Area) of Non-Consenting Parties' interests, or (iii) carry its proportionate part (determined as provided in (ii)) of Non-Consenting Parties' interests together with all or a portion of its proportionate part of any Non-Consenting Parties' interests that any Consenting Party did not elect to take. Any interest of Non-Consenting Parties that is not carried by a Consenting Party shall be deemed to be carried by the proposing party, and Operator shall perform all work required by the proposed operation. Failure to advise the proposing party within the time required shall be deemed an election under (i). In the event a drilling rig is on location, notice may be given by telephone, and the time permitted for such a response shall not exceed a total of forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays). The proposing party, at its election, may withdraw such proposal if there is less than 100% participation and shall notify all parties of such decision within ten (10) days, or within twenty-four (24) hours if a drilling rig is on location, following expiration of the applicable response period. If 100% subscription to the proposed operation is obtained, the proposing party shall promptly notify the Consenting Parties of their proportionate interests in the operation and the party serving as Operator shall commence such operation within the period provided in Article VI.B.1, subject to the same conditions as provided therein.

(b) Relinquishment of Interest for Non-Participation. The entire cost and risk of conducting such 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, then subject to Articles VI.B.6. and VI.E.3., the Consenting Parties shall plug and abandon the well and restore the surface location at their sole cost, risk and expense; provided, however, that those Non-Consenting Parties that participated in the drilling, Deepening or Sidetracking of the well shall remain liable for, and shall pay, their proportionate shares of the cost of plugging and abandoning the well and restoring the surface location insofar only as those costs were not increased by the subsequent operations of the Consenting Parties. If any well drilled, Reworked, Sidetracked, Deepened, Recompleted or Plugged Back under the provisions of this Article results in a well capable of producing Oil and/or Gas in paying quantities, the Consenting Parties shall Complete and equip the well to produce at their sole cost and risk, and the well shall then be turned over to Operator (if the Operator did not conduct the operation) and shall be operated by it at the expense and for the account of the Consenting Parties. Upon commencement of operations for the drilling, Reworking, Sidetracking, Recompleting, Deepening or Plugging Back of any such well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's interest in the well and share of production therefrom or, in the case of a Reworking, Sidetracking,
Article VI. DRILLING AND DEVELOPMENTS

B. SUBSEQUENT OPERATIONS (continued)

been increased as high as 800% or higher. If a party to the JOA wants to encourage the other parties to the JOA to participate in a proposed operation, that party will seek to include a high non-consent penalty. Cf. Crescent Drilling and Development v. Sealexco, Inc., 570 So.2d 151 (La. App. 3rd Cir. 1990).

This is especially true for the drilling of horizontal wells. Because of the cost and risk of drilling horizontal wells, large non-consent penalties should be inserted, or alternatively a farmout or blackout (relinquishment) provision could be incorporated in Article XVI. (See Articles XVI.G. and XVI.H. for examples.)

A question occasionally arises as to whether a party can elect to go non-consent as to a portion of its interest and participate as to the balance of its interest. The JOA does not address this issue and there is no authority to permit or deny this request. I do not believe this is permissible, unless the party legally assigns a portion of its interest to an affiliated or related party and Exhibit "A" properly reflects such a transfer. If this occurs, of course, the initial question is avoided, as now two parties exist.

Under certain circumstances, the parties may want to delete Article VI.B.2.(b) and incorporate an obligatory well or black-out provision in Article XVI which would operate to deny a Non-Consenting Party any right to the well and the surrounding acreage. (See Articles XVI.E., XVI.F. and XVI.G. for examples.)

A new provision clarifies that "Non-Consenting Parties who participated in the drilling of the well to the point of attempted Completion, Deepening or Plugging Back shall remain liable for, and shall pay, their proportionate shares of the cost of plugging and abandoning the well and restoring the surface location insofar only as those costs were not increased by the subsequent operations of the Consenting Parties." The 1982 Form does not specifically address the allocation of plugging costs in such situations. While the approach taken in this Form may precipitate disputes over the individual party's proper financial contribution, it is the most equitable, and it is another improvement. The parties should be able to ascertain the plugging costs by looking at the relevant drilling related AFE.

A new provision provides that if the well is not drilled to its objective depth, due to reasons other than encountering mechanical problems or impenetrable substances, those Non-Consenting Parties who voted for an alternative proposal to drill to a shallower depth, shall be entitled to participate in the Completion effort by paying
An election not to participate in the drilling, Sidetracking or Reeworking, during the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of the costs of operation of the well commencing with first production and continuing until each such Non-Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which would have been chargeable to such Non-Consenting Party had it participated in the well from the beginning of the operations; and

Notwithstanding anything to the contrary in the Article VI.B., the well does not reach the deepest objective Zone described in the notice proposing the well for reasons other than the encountering of granite or practically impenetrable substance or other condition in the hole rendering further operations impracticable, Operator shall give notice thereof to each Non-Consenting Party who submitted or voted for an alternative proposal under Article VI.B.6 to drill the well to a shallower Zone than the deepest objective Zone proposed in the notice under which the well was drilled, and each such Non-Consenting Party shall have the option to participate in the initial proposed Completion of the well by paying its share of the cost of drilling the well to its actual depth, calculated in the manner provided in Article VI.B.4. (a). If any such Non-Consenting Party does not elect to participate in the first Completion proposed for such well, the relinquishment provisions of this Article VI.B.2. (b) shall apply to such party's interest.

(c) Reworking, Recompleting or Plugging Back. An election not to participate in the drilling, Sidetracking or Deepening of a well shall be deemed an election not to participate in any Reworking or Plugging Back operation proposed in such a well, or portion thereof, to which the initial non-consent election applied that is conducted at any time prior to full recovery by the Consenting Parties of the Non-Consenting Party's recoupment amount. Similarly, an election not to participate in the Completing or Recompleting of a well shall be deemed an election not to participate in any Reworking operation proposed in such a well, or portion thereof, to which the initial non-consent election applied that is conducted at any time prior to full recovery by the Consenting Parties of the Non-Consenting Party's recoupment amount. Any such Reworking, Recompleting or Plugging Back operation conducted during the recoupment period shall be deemed part of the cost of operation of said well and there shall be added to the sums to be recouped by the Consenting Parties the

(ii) % of (a) that portion of the costs and expenses of drilling, Reworking, Sidetracking, Deepening, Recompleting, and Completions, after deducting any cash contributions received under Article VIII.C., and of (b) that portion of the cost of newly acquired equipment in the well (to and including the wellhead connections), which would have been chargeable to such Non-Consenting Party if it had participated therein.

Recoupment Matters. During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of all ad valorem, production, severance, excise, gathering and other taxes, and all royalty, overriding royalty and other burdens applicable to Non-Consenting Party's share of production not excepted by Article III.C. In the case of any Reworking, Sidetracking, Plugging Back, Recompleting or Deepening operation, the Consenting Parties shall be permitted to use, free of cost, all casing, tubing and other equipment in the well, but ownership of all such equipment shall remain unchanged, and upon abandonment of a well after such Reworking, Sidetracking, Plugging Back, Recompleting or Deepening, the Consenting Parties shall account for all such equipment to the owners thereof, with each party receiving its proportionate part in kind or in value, less cost of salvage.

Within ninety (90) days after the completion of any operation under this Article, the party conducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an inventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling, Sidetracking, Deepening, Plugging Back, testing, Completing, Recompleting, and equipping the well for production; or, at its option, the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being reimbursed as provided above, the party conducting the operations for the Consenting Parties shall furnish the Non-Consenting Parties with an itemized statement of all costs and liabilities 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 realized from the sale of the well's working interest production during the preceding month. In determining the quantity of Oil and Gas produced during any month, Consenting Parties shall use industry accepted methods such as but not limited to metering or periodic well tests. Any amount realized from the sale or other disposition of equipment newly acquired in connection with any such operation which would have been owned by a Non-Consenting Party had it participated therein shall be credited against the total unrecovered costs of the work done and of the equipment purchased in determining when the interest of such Non-Consenting Party shall revert to it as above provided; and if there is a credit balance, it shall be paid to such Non-Consenting Party.

4. If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest the amounts provided for above, the relinquished interests of such Non-Consenting Party shall automatically revert to it as of 7:00 a.m. on the day following the day on which such recoupment occurs, and, from and after such revestment, such Non-Consenting Party shall own the same interest in such well, the material and equipment in or pertaining thereto, and the production therefrom as such Non-Consenting Party would have been entitled to had it participated in the drilling, Sidetracking, Reworking, Deepening, Recompleting or Plugging Back of said well. Thereafter, such Non-Consenting Party shall be charged with and shall pay its proportionate part of the further costs of the operation of said well in accordance with the terms of this agreement and Exhibit "C" attached hereto.

3. Stand-By Costs. When a well which has been drilled or Deepened has reached its authorized depth and all costs have been completed and the results thereof furnished to the parties, or when operations on the well have been otherwise terminated pursuant to Article VI.F., stand-by costs incurred pending response to a party's notice proposing a Reworking,
Article VI. DRILLING AND DEVELOPMENTS

B. SUBSEQUENT OPERATIONS (continued)

their share of drilling costs to the actual depth drilled. Once again, the drafters have clarified a previously unresolved matter. The provision implicitly assumes that all Drilling Parties have agreed to curtail drilling operations, prior to reaching the objective depth, pursuant to Article VI.F. To eliminate potential conflicts it may be advisable to explicitly state that the Drilling Parties have agreed to curtail drilling operations, pursuant to Article VI.F.

The 1982 Form provided for a 100% penalty for any Reworking, Recompleting, or Plugging Back operation conducted during the recoupment period of a non-consent operation. This Form replaces the 100% penalty with a blank. Rarely, did parties revise the 1982 Form to increase or decrease the penalty. With the incorporation of a blank, parties will likely seek a higher penalty as compensation for the risk involved in such operation and the time value of money.

A detailed provision on Deepening has been added. In summary, Non-Consenting Parties can participate in the Deepening of a well. If the proposal to Deepen is made prior to the Completion of a commercial well, the Non-Consenting Party wishing to participate in the Deepening shall reimburse the Drilling Parties for their proportionate share of expenses. The Non-Consenting Party is not obligated for the costs of testing and Completion prior to the Deepening operation. If, however, the well has been previously completed as a commercial well, but is no longer producing in paying quantities, the Non-Consenting Party wishing to participate in the Deepening shall reimburse the Drilling Parties for their proportionate share of drilling, Completing and equipping less those costs recouped by the Consenting Parties from the sale of production from the well. The Non-Consenting Parties shall pay their proportionate share of the costs of salvable equipment in the hole and on the surface.

A Sidetracking provision similar to that of the Deepening provision has been incorporated. Interestingly, the Sidetracking provision does not exactly track the Deepening provision. As a consequence, differences in application of the provisions relating to Deepening and Sidetracking may occur. The reasons for this are unclear. Before specific language was included in the JOA addressing Sidetracking, it was unclear if Sidetracking was or was not a subsequent operation requiring a party's consent to be liable for such associated cost. See Holt Oil & Gas Corp. v. Harvey, 801 F.2d 773 (5th Cir. 1986), reh. den. (1986) where the court ruled that a JOA (vintage not named) did not clearly provide that Sidetracking was a subsequent operation. And, therefore, even though the Non-Operator elected not to participate, he was still
Sidetracking, Deepening, Recompleting, Plugging Back or Completing operation in such a well (indicating the period required
under Article VI.B.6. to resolve competing proposals) shall be charged and borne as part of the drilling or Deepening
operation just completed. Stand-by costs subsequent to all parties responding, or expiration of the response time permitted,
whichever first occurs, and prior to agreement as to the participating interests of all Consenting Parties pursuant to the terms
of the second grammatical paragraph of Article VI.B.2. (a), shall be charged to and borne as part of the proposed operation,
but if the proposal is subsequently withdrawn because of insufficient participation, such stand-by costs shall be allocated
between the Consenting Parties in the proportion of each Consenting Party's interest as shown on Exhibit "A" bears to the total
interest as shown on Exhibit "A" of all Consenting Parties.

In the event that notice for a Sidetracking operation is given while the drilling rig to be utilized is on location, any party
may request and receive up to five (5) additional days after expiration of the forty-eight hour response period specified in
Article VI.B.1. within which to respond by paying for all stand-by costs and other costs incurred during such extended
response period. Operator may require such party to pay the estimated stand-by time in advance as a condition to extending
the response period. If more than one party elects to take such additional time to respond to the notice, standby costs shall be
allocated between the parties taking additional time to respond on a day-to-day basis in the proportion each electing party's
interest as shown on Exhibit "A" bears to the total interest as shown on Exhibit "A" of all the electing parties.

4. Deepening. If less than all the parties elect to participate in a drilling, Sidetracking, or Deepening operation proposed
pursuant to Article VI.B.1., the interest relinquished by the Non-Consenting Parties to the Consenting Parties under Article
VI.B.2. shall relate only and be limited to the lesser of (i) the total depth actually drilled or (ii) the objective depth or Zone
of which the parties were given notice under Article VI.B.1. ("Initial Objective"). Such well shall not be Deepened beyond the
Initial Objective without first complying with this Article to afford the Non-Consenting Parties the opportunity to participate
in the Deepening operation.

In the event any Consenting Party desires to drill or Deepen a Non-Consent Well to a depth below the Initial Objective, such
party shall give notice thereof, complying with the requirements of Article VI.B.1., to all parties (including Non-
Consenting Parties). Thereupon, Articles VI.B.1. and 2. shall apply and all parties receiving such notice shall have the right
to participate or not participate in the Deepening of such well pursuant to said Articles VI.B.1. and 2. If a Deepening operation
is approved pursuant to such provisions, and if any Non-Consenting Party elects to participate in the Deepening operation,
such Non-Consenting party shall pay or make reimbursement (as the case may be) of the following costs and expenses:

(a) If the proposal to Deepen is made prior to the completion of such well as a well capable of producing in paying
quantities, such Non-Consenting Party shall pay (or reimburse Consenting Parties for, as the case may be) that share of costs
and expenses incurred in connection with the drilling of said well from the surface to the Initial Objective which Non-
Consenting Party would have paid had such Non-Consenting Party agreed to participate therein, plus the Non-Consenting
Party's share of the cost of Deepening and of participating in any further operations on the well in accordance with the other
provisions of this Agreement; provided, however, all costs for testing and Completion or attempted Completion of the well
incurred by Consenting Parties prior to the point of actual operations to Deepen beyond the Initial Objective shall be for the
sole account of Consenting Parties.

(b) If the proposal is made for a Non-Consent Well that has been previously Completed as a well capable of producing
in paying quantities, but is no longer capable of producing in paying quantities, such Non-Consenting Party shall pay (or
reimburse Consenting Parties for, as the case may be) its proportionate share of all costs of drilling, Completing, and
equipping said well from the surface to the Initial Objective, calculated in the manner provided in paragraph (a) above, less
those costs recouped by the Consenting Parties from the sale of production from the well. The Non-Consenting Party shall
also pay its proportionate share of all costs of re-entering said well. The Non-Consenting Parties' proportionate part (based
on the percentage of such well Non-Consenting Party would have owned had it previously participated in such Non-Consent
Well) of the costs of salvable materials and equipment remaining in the hole and salvable surface equipment used in
connection with such well shall be determined in accordance with Exhibit "C." If the Consenting Parties have recouped the
cost of drilling, Completing, and equipping the well at the time such Deepening operation is conducted, then a Non-
Consenting Party may participate in the Deepening of the well with no payment for costs incurred prior to re-entering the
well for Deepening.

The foregoing shall not imply a right of any Consenting Party to propose any Deepening for a Non-Consent Well prior to
the drilling of such well to its Initial Objective without the consent of the other Consenting Parties as provided in Article
VI.F.

5. Sidetracking. Any party having the right to participate in a proposed Sidetracking operation that does not own an
interest in the affected wellbore at the time of the notice shall, upon electing to participate, tender to the wellbore owners its
proportionate share (equal to its interest in the Sidetracking operation) of the value of that portion of the existing wellbore
to be utilized as follows:

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

(b) If the proposal is for Sidetracking a well which has previously produced, reimbursement shall be on the basis of
such party's proportionate share of drilling and equipping costs incurred to the initial drilling of the well down to the depth
at which the Sidetracking operation is conducted, calculated in the manner described in Article VI.B.4(b) above. Such party's
proportionate share of the cost of the well's salvable materials and equipment down to the depth at which the Sidetracking
operation is initiated shall be determined in accordance with the provisions of Exhibit "C."

6. Order of Preference of Operations. Except as otherwise specifically provided in this agreement, if any party desires to
propose the conduct of an operation that conflicts with a proposal that has been made by a party under this Article VI, such
party shall have fifteen (15) days from delivery of the initial proposal, in the case of a proposal to drill a well or to perform
an operation on a well where no drilling rig is on location, or twenty-four (24) hours, exclusive of Saturday, Sunday and legal
holidays, from delivery of the initial proposal, if a drilling rig is on location for the well on which such operation is to be
conducted, to deliver to all parties entitled to participate in the proposed operation such party's alternative proposal, such
alternate proposal to contain the same information required to be included in the initial proposal. Each party receiving such
proposals shall elect by delivery of notice to Operator within five (5) days after expiration of the proposal period, or within
twenty-four (24) hours (exclusive of Saturday, Sunday and legal holidays) if a drilling rig is on location for the well that is the
subject of the proposals, to participate in one of the competing proposals. Any party not electing within the time required
shall be deemed not to have voted. The proposal receiving the vote of parties owning the largest aggregate percentage
interest of the parties voting shall have priority over all other competing proposals; in the case of a tie vote, the
Article VI. DRILLING AND DEVELOPMENTS

B. SUBSEQUENT OPERATIONS (continued)

liable for its share of costs. This problem should not arise under the 1989 Form as Sidetracking is explicitly referred to in Article VI.B.1. as a subsequent operation.

Under the 1982 Form, proposals are apparently considered on a first come first served basis. This Form provides for a procedure to choose between conflicting proposals. Alternative proposals can be offered if disseminated within 15 days (or 24 hours if a drilling rig is on location) of the initial proposal. Five days after the running of the proposal period (24 hours if a drilling rig is on location), each party must vote on the competing proposals. The majority interest prevails. In the event of a tie vote, the initial proposal prevails. Any party who fails to vote for a conflicting proposal is deemed to have not voted. The Operator shall within 5 days after the expiration of the election period (or 24 hours if a drilling rig is on location) advise all parties, who are entitled to participate, as to the results of the vote. Thereafter, each party (entitled to participate) shall within two days (or 24 hours if a drilling rig is on location) notify the Operator as to whether it wishes to participate or go non-consent on the proposed operation. In connection with this final election, the failure to timely respond shall be deemed an election not to participate in the prevailing proposed operation. Finally, the words "exclusive of Saturday, Sunday and legal holidays" was inadvertently dropped after the word "hours" and before the word "if" on line 3 of Article VI.B.6.

If all notices are received on the day sent (sent by electronic mail), this procedure will extend the proposal period by a maximum of 12 days (or 3 days if a drilling rig is on location). This is a reasonable price to pay to ensure the airing and analysis of conflicting proposals. Hopefully, this procedure will result in the conducting of better reasoned operations. At a bare minimum, all parties will have the opportunity to propose, discuss and vote for those operations which they think are advisable. No longer will the arbitrary, first offer rule apply. This provision is a significant improvement over the 1982 Form. Under the 1982 Form, a poorly thought out proposal or a manipulative proposal if done first could force the other parties to either elect not to participate or elect to participate in an unreasonably risky and/or needlessly expensive operation.

The drafters prohibited proposals from being made that do not comply with the then existing spacing. Under Article VI.B.7, an increased density well "cannot be proposed until the spacing has been revised." In addition, this new provision brings certainty to the issue of what can be done to a commercial well by stating that "[N]o party shall conduct any Reworking, Deepening, Plugging Back, Completion or
initial proposal shall prevail. Operator shall deliver notice of such result to all parties entitled to participate in the operation
within five (5) days after expiration of the election period (or within twenty-four (24) hours, exclusive of Saturday, Sunday
and legal holidays, if a drilling rig is on location). Each party shall then have two (2) days (or twenty-four (24) hours if a rig
is on location) from receipt of such notice to elect by delivery of notice to Operator to participate in such operation or to
relinquish interest in the affected well pursuant to the provisions of Article VI.B.2.; failure by a party to deliver notice within
such period shall be deemed an election not to participate in the prevailing proposal.
7. Conformity to Spacing Pattern. Notwithstanding the provisions of this Article VI.B.2., it is agreed that no wells shall be
proposed to be drilled or Completed in or produced from a Zone from which a well located elsewhere on the Contract
Area is producing, unless such well conforms to the then-existing well spacing pattern for such Zone.
8. Reworking Wells. No party shall conduct any Reworking, Deepening, Plugging Back, Completion, Recompletion, or
Sidetracking operation under this agreement with respect to any well then capable of producing in paying quantities except
with the consent of all parties that have not relinquished interests in the well at the time of such operation.
9. Completion. Without the consent of all parties, no well shall be drilled, Deepened or Sidetracked, except any well
drilled, Deepened or Sidetracked pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling,
Deepening or Sidetracking shall include:
   □ Option No 1: All necessary expenditures for the drilling, Deepening or Sidetracking, testing, Completing and
   equipping of the well, including necessary tankage and/or surface facilities.
   □ Option No 2: All necessary expenditures for the drilling, Deepening or Sidetracking and testing of the well. When
   such well has reached its authorized depth, and all logs, cores and other tests have been completed, and the results
   thereof furnished to the parties, Operator shall give immediate notice to the Non-Operators having the right to
   participate in a Completion attempt whether or not Operator recommends attempting to Complete the well, together
   with Operator’s AFE for Completion costs if not previously provided. The parties receiving such notice
   shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect by delivery of
   notice to Operator to participate in a recommended Completion attempt or to make a Completion proposal with an
   accompanying AFE. Operator shall deliver such Completion proposal conflicting with Operator's proposal, to the other parties entitled to participate in such Completion in accordance with the
   procedures specified in Article VI.B.6. Election to participate in a Completion attempt shall include consent to all
   necessary expenditures for the Completing and equipping of such well, including necessary tankage and/or surface
   facilities but excluding any stimulation operation not contained on the Completion AFE. Failure of any party
   receiving such notice to reply within the period above fixed shall constitute an election by that party not to
   participate in the cost of the Completion attempt; provided, that Article VI.B.6. shall control in the case of
   conflicting Completion proposals. If one or more, but less than all of the parties, elect to attempt a Completion, the
   provisions of Article VI.B.2. hereof (the phrase "Reworking, Sidetracking, Deepening, Re-completing or Plugging
   Back" as contained in Article VI.B.2. shall be deemed to include "Completion") shall apply to the operations
   thereafter conducted by less than all parties; provided, however, that Article VI.B.2. shall apply separately to each
   separate Completion or Recompletion attempt undertaken hereunder, and an election to become a Non-Consenting
   Party as to one Completion or Recompletion attempt shall not prevent a party from becoming a Consenting Party
   in subsequent Completion or Recompletion attempts regardless whether the Consenting Parties as to earlier
   Completions or Re-completions have recouped their costs pursuant to Article VI.B.2.; provided further, that any
   recoupment of costs by a Consenting Party shall be made solely from the production attributable to the Zone in
   which the Completion attempt is made. Election by a previous Non-Consenting Party to participate in a subsequent
   Completion or Recompletion attempt shall require such party to pay its proportionate share of the cost of salvageable
   materials and equipment installed in the well pursuant to the prevailing Completion or Recompletion attempt,
insofar and only insofar as such materials and equipment benefit the Zone in which such party participates in a
   Completion attempt.
2. Rework, Re-complete or Plug Back. No well shall be Reworked, Re-completed or Plugged Back except a well Reworked,
Re-completed, or Plugged Back pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the Reworking,
Re-completing or Plugging Back of a well shall include all necessary expenditures in conducting such operations and
Completing and equipping of said well, including necessary tankage and/or surface facilities.
D. Other Operations:
   □ Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of
   Dollars ($_________) except in connection with the drilling, Sidetracking, Reworking, Deepening, Completing, Re-completing or Plugging Back of a well that has been previously
   authorized by or pursuant to this agreement; provided, however, that, in the case of explosion, fire, flood or other sudden
emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion
   are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the
   emergency to the other parties. If Operator prepares an AFE for its own use, Operator shall furnish any Non-Operator so
   requesting an information copy thereof for any single project costing in excess of
   Dollars ($_________). Any party who has not relinquished its interest in a well shall have the right to propose that
   Operator perform repair work or undertake the installation of artificial life equipment or ancillary production facilities such as
   salt water disposal wells or to conduct additional work with respect to a well drilled hereunder or other similar project (but
   not including the installation of gathering lines or other transportation or marketing facilities, the installation of which shall
   be governed by separate agreement between the parties) reasonably estimated to require an expenditure in excess of the
   amount first set forth above in this Article VI.D. (except in connection with an operation required to be proposed under
   Articles VI.B.1. or VI.C.1. Option No. 2, which shall be governed exclusively by those Articles). Operator shall deliver such
   proposal to all parties entitled to participate therein. If within thirty (30) days thereof Operator secures the written consent
   of any party or parties owning at least % of the interests of the parties entitled to participate in such operation, each
   party having the right to participate in such project shall be bound by the terms of such proposal and shall be obligated
   to pay its proportionate share of the costs of the proposed project as if it had consented to such project pursuant to the terms
   of the proposal.
E. Abandonment of Wells:
   1. Abandonment of Dry Holes. Except for any well drilled or Deepened pursuant to Article VI.B.2., any well which has
   been drilled or Deepened under the terms of this agreement and is proposed to be completed as a dry hole shall not be
Article VI. DRILLING AND DEVELOPMENTS

C. COMPLETION OF WELLS; REWORKING AND PLUGGING BACK

Sidetracking operation under this agreement with respect to any well then capable of producing in paying quantities except with the consent of all parties that have not relinquished interests in the well at the time of such operation."

The casing point election (Option No. 2) has been expanded to require the dissemination of a Completion cost Authority for Expenditure (AFE). In addition, a procedure similar to that which is used for subsequent operations has been incorporated to handle conflicting Completion proposals. Finally, it is now possible to elect to not participate in one Completion attempt, and should that Completion attempt fail, participate in another Completion attempt.

Once again, certain parties may not like the results of the new language, but at least the new Form resolves an ambiguity. If the parties wish, they can revise this provision to eliminate a party's ability to elect not to participate in one Completion, and if the Completion should fail, to participate in subsequent Completion attempts.

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. Option No. 1 should generally be selected when the parties intend to drill a horizontal well. Horizontal wells are currently drilled as completed wells and, therefore, all costs through Completion should be authorized. This recommendation will, of course, change if the technology of drilling horizontal wells permits a casing point election. If both vertical and horizontal wells may be proposed, Option No. 1 may be selected and designated to apply to only horizontal wells and Option No. 2 may be selected and designated to apply to only vertical wells.

AFEs are disseminated to satisfy Article VI.B.1., which mandates that notice be given of any proposed operation, specifying work to be performed, location, proposed depth, objective formations and estimated cost of the operation. AFEs are generally considered estimates of the costs anticipated and not firm commitments. In Sonat Exploration Co. v. Mann, 785 F.2d 1232 (5th Cir. 1986), the Fifth Circuit, interpreting Mississippi law, held that AFEs 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-
initial proposal shall prevail. Operator shall deliver notice of such result to all parties entitled to participate in the operation within five (5) days after expiration of the election period (or within twenty-four (24) hours, exclusive of Saturday, Sunday and legal holidays, if a drilling rig is on location). Each party shall then have two (2) days (or twenty-four (24) hours if a rig is on location) from receipt of such notice to elect by delivery of notice to Operator to participate in such operation or to relinquish interest in the affected well pursuant to the provisions of Article VI.B.2.; failure by a party to deliver notice within such period shall be deemed an election not to participate in the prevailing proposal.  

7. Conformity to Spacing Pattern. Notwithstanding the provisions of this Article VI.B.2., it is agreed that no wells shall be proposed to be drilled or Recompleted in or produced from a Zone from which a well located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such Zone. 

8. Deepening, Plugging Back. No party shall conduct any Reworking, Deepening, Plugging Back, Completion, Recompletion, or Sidetracking operation under this agreement with respect to any well then capable of producing in paying quantities except with the consent of all parties that have not relinquished interests in the well at the time of such operation. 

C. Completion of Wells; Reworking and Plugging Back: 

1. Completion. Without the consent of all parties, no well shall be drilled, Deepened or Sidetracked, except any well drilled, Deepened or Sidetracked pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling, Deepening or Sidetracking shall include:

☐ Option No 1: All necessary expenditures for the drilling, Deepening or Sidetracking, testing, Completing and equipping of the well, including necessary tankage and/or surface facilities.

☐ Option No 2: All necessary expenditures for the drilling, Deepening or Sidetracking and testing, of the well. When such well has reached its authorized depth, and all logs, cores and other tests have been completed, and the results thereof furnished to the parties, Operator shall give immediate notice to the Non-Operators having the right to participate in a Completion attempt whether or not Operator recommends attempting to Complete the well, together with Operator's AFE for Completion costs if not previously provided. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect by delivery of notice to Operator to participate in a recommended Completion attempt or to make a Completion proposal with an accompanying AFE. Operator shall deliver any such Completion proposal conflicting with Operator's proposal, to the other parties entitled to participate in such Completion in accordance with the procedures specified in Article VI.B.6. Election to participate in a Completion attempt shall include consent to all necessary expenditures for the Completing and equipping of such well, including necessary tankage and/or surface facilities but excluding any stimulation operation not contained on the Completion AFE. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the Completion attempt; provided, that Article VI.B.6. shall control in the case of conflicting Completion proposals. If one or more, but less than all of the parties, elect to attempt a Completion, the provisions of Article VI.B.2. hereof (the phrase "Reworking, Sidetracking, Deepening, Recompleting or Plugging Back" as contained in Article VI.B.2. shall be deemed to include "Completing") shall apply to the operations thereafter conducted by less than all parties; provided, however, that Article VI.B.2. shall apply separately to each separate Completion or Recompletion attempt undertaken hereunder, and an election to become a Non-Consenting Party to one Completion or Recompletion attempt shall not prevent a party from becoming a Consenting Party in subsequent Completion or Recompletion attempts regardless whether the Consenting Parties as to earlier Completions or Recompletions have recouped their costs pursuant to Article VI.B.2., provided further, that any recoupment of costs by a Consenting Party shall be made solely from the production attributable to the Zone in which the Completion attempt is made. Election by a previous Non-Consenting Party to participate in a subsequent Completion or Recompletion attempt shall require such party to pay its proportionate share of the cost of salvageable materials and equipment installed in the well pursuant to the Completion or Recompletion attempt, insofar and only insofar as such materials and equipment benefit the Zone in which such party participates in a Completion attempt. 

2. Rework, Recomplete or Plug Back. No well shall be Reworked, Recompleted or Plugged Back except a well Reworked, Recompleted, or Plugged Back pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the Reworking, Recompleting or Plugging Back of a well shall include all necessary expenditures in conducting such operations and Completing and equipping of said well, including necessary tankage and/or surface facilities. 

D. Other Operations: 

Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of (Dollars ($___________)) except in connection with the drilling, Sidetracking, Reworking, Deepening, Completing, Recompleting or Plugging Back of a well that has been previously authorized by or pursuant to this agreement; provided, however, that, in the case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares an AFE for its own use, Operator shall furnish any Non-Operator so requesting an information copy thereof for any single project costing in excess of (Dollars ($___________)). Any party who has not relinquished its interest in a well shall have the right to propose that Operator perform repair work or undertake the installation of artificial life equipment or ancillary production facilities such as salt water disposal wells or to conduct additional work with respect to a well drilled hereunder or other similar project (but not including the installation of gathering lines or other transportation or marketing facilities, the installation of which shall be governed by separate agreement between the parties) reasonably estimated to require an expenditure in excess of the amount first set forth above in this Article VLD (except in connection with an operation required to be proposed under Articles VI.B.1. or VI.C.1. Option No. 2, which shall be governed exclusively by those Articles). Operator shall deliver such proposal to all parties entitled to participate therein. If within thirty (30) days thereof Operator secures the written consent of any party or parties owning at least % of the interests of the parties entitled to participate in such operation, each party having the right to participate in such project shall be bound by the terms of such proposal and shall be obligated to pay its proportionate share of the costs of the proposed project as if it had consented to such project pursuant to the terms of the proposal. 

E. Abandonment of Wells: 

1. Abandonment of Dry Holes. Except for any well drilled or Deepened pursuant to Article VI.B.2., any well which has been drilled or Deepened under the terms of this agreement and is proposed to be completed as a dry hole shall not be
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C. COMPLETION OF WELLS; REWORKING AND PLUGGING BACK (continued)

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. See French v. Joseph E. Seagram & Sons, Inc., 439 S.W.2d 448 (Tex. App. 1969) where the court reaffirmed the general rule that unless specifically required the approval of an AFE by Non-Operators under a JOA is not necessary for a proposed well to be drilled.

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 Operator would bear all excess costs. Alternatively, the Non-Operator could attempt to 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 Operating Agreement, the AFE and COPAS -- What They Fail to Provide, 29 ROCKY MT. MIN. L. INST. 743 (1983). (See Article XVI.Q. for an example.)

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 relationship 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-Operators 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.

Several cases have considered the Non-Operator's conduct in implicitly agreeing to
initial proposal shall prevail. Operator shall deliver notice of such result to all parties entitled to participate in the operation within five (5) days after expiration of the election period (or within twenty-four (24) hours, exclusive of Saturday, Sunday and legal holidays, if a drilling rig is on location). Each party shall then have two (2) days (or twenty-four (24) hours if a rig is on location) from receipt of such notice to elect by delivery of notice to Operator to participate in such operation or to relinquish interest in the affected well pursuant to the provisions of Article VI.B.2.; failure by a party to deliver notice within such period shall be deemed an election not to participate in the prevailing proposal.

7. Conformity to Spacing Pattern: Notwithstanding the provisions of this Article VI.B.2., it is agreed that no wells shall be proposed to be drilled or to be Comleted in or produced from a Zone from which a well located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing well spacing pattern for such Zone.

8. Rework, Recomplete or Plug Back: No party shall conduct any Reworking, Deepening, Plugging Back, Completion, Recompletion, or Sidetracking operation under this agreement with respect to any well then capable of producing in paying quantities except with the consent of all parties that have not relinquished interests in the well at the time of such operation.

C. Completion of Wells; Reworking and Plugging Back:

1. Completion. Without the consent of all parties, no well shall be drilled, Deepened or Sidetracked, except any well drilled, Deepened or Sidetracked pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the drilling, Deepening or Sidetracking shall include:

   Option No 1: All necessary expenditures for the drilling, Deepening or Sidetracking, testing, Completing and equipping of the well, including necessary tankage and/or surface facilities.

   Option No 2: All necessary expenditures for the drilling, Deepening or Sidetracking and testing of the well. When such well has reached its authorized depth, and all logs, cores and other tests have been completed, and the results thereof furnished to the parties, Operator shall give immediate notice to the Non-Operators having the right to participate in a Completion attempt whether or not Operator recommends attempting to Complete the well, together with Operator's AFE for Completion costs if not previously provided. The parties receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect by delivery of notice to Operator to participate in a recommended Completion attempt or to make a Completion proposal with an accompanying AFE. Operator shall deliver any such Completion proposal conflicting with Operator's proposal, to the other parties entitled to participate in such Completion in accordance with the procedures specified in Article VI.B.6. Election to participate in a Completion attempt shall include consent to all necessary expenditures for the Completing and equipping of such well, including necessary tankage and/or surface facilities but excluding any stimulation operation not contained on the Completion AFE. Failure of any party receiving such notice to reply within the period above fixed shall constitute an election by that party not to participate in the cost of the Completion attempt; provided, that Article VI.B.6. shall control in the case of conflicting Completion proposals. If one or more, but less than all of the parties, elect to attempt a Completion, the provisions of Article VI.B.2. hereof (the phrase "Reworking, Sidetracking, Deepening, Recompleting or Plugging Back" as contained in Article VI.B.2. shall be deemed to include "Completion") shall apply to the operations thereafter conducted by less than all parties; provided, however, that Article VI.B.2. shall apply separately to each separate Completion or Recompletion attempt undertaken hereunder, and an election to become a Non-Consenting Party as to one Completion or Recompletion attempt shall not prevent a party from becoming a Consenting Party in subsequent Completion or Recompletion attempts regardless whether the Consenting Parties as to earlier Completions or Recompletions have recouped their costs pursuant to Article VI.B.2., provided further, that any recoupment of costs by a Consenting Party shall be made solely from the production attributable to the Zone in which the Completion attempt is made. Election by a previous Non-Consenting Party to participate in a subsequent Completion or Recompletion attempt shall require such party to pay its proportionate share of the cost of salvable materials and equipment installed in the well pursuant to the previous Completion or Recompletion attempt, and only insofar as such materials and equipment benefit the Zone in which such party participates in a Completion attempt.

2. Rework, Recomplete or Plug Back. No well shall be Reworked, Recompleted or Plugged Back except a well Reworked, Recompleted, or Plugged Back pursuant to the provisions of Article VI.B.2. of this agreement. Consent to the Reworking, Recompleting or Plugging Back of a well shall include all necessary expenditures in conducting such operations and Completing and equipping of said well, including necessary tankage and/or surface facilities.

D. Other Operations:

Operator shall not undertake any single project reasonably estimated to require an expenditure in excess of ______________________ Dollars ($_________________) except in connection with the drilling, Sidetracking, Reworking, Deepening, Completing, Recompleting or Plugging Back of a well that has been previously authorized by or pursuant to this agreement; provided, however, that, in the case of explosion, fire, flood or other sudden emergency, whether of the same or different nature, Operator may take such steps and incur such expenses as in its opinion are required to deal with the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emergency to the other parties. If Operator prepares an AFE for its own use, Operator shall deliver any Non-Operator so requesting an information copy thereof for any single project costing in excess of ______________________ Dollars ($_________________) . Any party who has not relinquished its interest in a well shall have the right to propose that Operator perform repair work or undertake the installation of artificial life equipment or ancillary production facilities such as salt water disposal wells or to conduct additional work with respect to a well drilled hereunder or other similar project (but not including the installation of gathering lines or other transportation or marketing facilities, the installation of which shall be governed by separate agreement between the parties) reasonably estimated to require an expenditure in excess of the amount first set forth above in this Article V.LD. (except in connection with an operation required to be proposed under Articles VI.B.1. or VI.C.1. Option No. 2, which shall be governed exclusively by those Articles). Operator shall deliver such proposal to all parties entitled to participate therein. If within thirty (30) days thereof Operator secures the written consent of any party or parties owning at least __________% of the interests of the parties entitled to participate in such operation, each party having the right to participate in such project shall be bound by the terms of such proposal and shall be obligated to pay its proportionate share of the costs of the proposed project as if it had consented to such project pursuant to the terms of the proposal.

E. Abandonment of Wells:

1. Abandonment of Dry Holes. Except for any well drilled or Deepened pursuant to Article VI.B.2., any well which has been drilled or Deepened under the terms of this agreement and is proposed to be completed as a dry hole shall not be
C. COMPLETION OF WELLS; REWORKING AND PLUGGING BACK (continued)

proposed operations or waiving objections thereto. The court in *Bluebonnet Oil and Gas Co. v. Panuco Oil Leases, Inc.*, 323 S.W.2d 334 (Tex. App. 1959) held that the Non-Operator's conduct indicated approval of the drilling proposal even though the election period had run prior to the commencement of the well. However, in *Colorado Springs National Bank v. Ferebee*, 486 P.2d 456 (Co. App. 1971) the court ruled that failure to respond to a well proposal in accordance with the procedures of the JOA, did not constitute an election to participate. Likewise, a Non-Operator has been found liable for its share of well cost where it had not signed the JOA. *Great Western Oil & Gas Co. v. Mitchell*, 326 P.2d 794 (Okla. 1958). Finally, in *Buttes Gas and Oil Co., v. Willard Pease Drilling Co.*, 467 F.2d 281 (10th Cir. 1972) a party who had knowledge of excessive cost when the cost was incurred and failed to timely object, waived any right to object at a later date.

D. OTHER OPERATIONS

The Form improves the efficiency of production operations. In the 1982 Form, project expenses in excess of what is so provided by the parties in the JOA (by inserting a number in the blank) have to be approved by all Consenting Parties. This burdensome provision is often ignored by the Operator. Under this Form, repair work, the installation of artificial lift equipment or ancillary production facilities and certain other work can be undertaken with the "written consent of any party or parties owning at least __________% of the interests of the parties entitled to participate in such operation . . . ." The concept is a definite improvement. Complete the blank to allow a majority of the parties or in certain instances a majority of the percentage interest to approve such expenditures.

E. ABANDONMENT OF WELLS

The drafters have improved the 1982 Form by requiring that a party who elects to take over a well provide satisfactory proof of its financial capability to take over the well. In light of the possibility of environmental liability, parties need to be increasingly vigilant in ensuring that successor Operators have the financial wherewithal to make good on their indemnities. To this end, this Form requires that a successor Operator provide "proof reasonably satisfactory to Operator of its financial capacity to conduct such operations or to take over the well" and indemnify the abandoning parties, before taking over the well. It would be advisable to amend the provision to require not just an "indemnity," but an "indemnity to the reasonable satisfaction of Operator." This satisfactory indemnity requirement shall be imposed
plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after delivery of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling or Deepening such well. Any party who objects to plugging and abandoning such well by notice delivered to Operator within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after delivery of notice of the proposed plugging shall take over the well as of the end of such forty-eight (48) hour notice period and conduct further operations in search of Oil and/or Gas subject to the provisions of Article VI.B.; failure of such party to provide proof reasonably satisfactory to Operator of its financial capability to conduct such operations or to take over the well within such period or thereafter to conduct operations on such well or plug and abandon such well shall entitle Operator to retain or take possession of the well and plug and abandon the well. The party taking over the well shall indemnify Operator (if Operator is an abandoning party) and the other abandoning parties against liability for any further operations conducted on such well except for the costs of plugging and abandoning the well and restoring the surface, for which the abandoning parties shall remain proportionately liable.

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

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

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

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

F. Termination of Operations:

Upon the commencement of an operation for the drilling, Reworking, Sidetracking, Plugging Back, Deepening, testing, completion or plugging of a well, including but not limited to the Initial Well, such operation shall not be terminated without consent of parties bearing 100% of the costs of such operation; provided, however, that in the event granite or other practically impenetrable substance or condition in the hole is encountered which renders further operations impractical, Operator may discontinue operations and give notice of such condition in the manner provided in Article VI.B.; and the provisions of Article VI.B. and VI.E. shall thereafter apply to such operation, as appropriate:

G. Taking Production in Kind:

- Option No. 1: Gas Balancing Agreement Attached
- Each party shall take in kind or separately dispose of its proportionate share of all Oil and Gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating Oil and Gas for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any 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 required to pay for only its proportionate share of such part of Operator's surface facilities which it uses.
- Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment
Article VI. DRILLING AND DEVELOPMENTS

E. ABANDONMENT OF WELLS (continued)

on both dry holes and wells that have produced.

A sentence has been added which makes it clear that if the costs of plugging and abandoning and surface restoration exceed the salvage value, the abandoning parties will have to pay the party taking over the well for its proportionate share of the difference.

Otherwise the abandonment procedure remains unchanged. Parties wishing to take over a well which was drilled as a dry hole shall do so in accordance with the non-consent provisions of Article VI.B. Parties wishing to take over a well that was previously produced shall do so by acquiring a lease on the Zone then open to production. No well shall be plugged and abandoned unless all parties with an interest in the well consent to such operations.

Operators have been held not responsible for notifying Non-Operators of plugging and abandonment operations which would result in the termination of a lease. In Fuller v. Phillips Petroleum Co., 872 F.2d 655 (5th Cir. 1989), the court held that the Operator did not breach the JOA by failing to notify the Non-Operator of the impending plugging and abandonment. Fuller, as Non-Operator, and Phillips Petroleum Company, as Operator, were parties to a 1964 JOA covering leases on which the Holliday A-1 Well was drilled. The well ceased production in 1983, and after cessation of production for more than 60 days certain leases upon which the well was located terminated. Phillips notified Fuller of its intention to plug and abandon the well after the leases terminated. Fuller brought this lawsuit alleging Phillips' liability for failure to notify Fuller of its intention to plug and abandon the well prior to the date of lease expiration.

After analyzing various provisions of the JOA (which was apparently an early A.A.P.L. Model Form) the trial court found no express provision requiring notification of a pending lease expiration and declined to imply such a provision into the agreement. The 5th Circuit Court of Appeals, after analysis of the express provisions in the agreement concerning abandonment of wells, renewal and extension of leases and failure of title, affirmed the lower court's holding, concluding that the Operator had no obligation to notify the Non-Operator of an impending lease termination. The court distinguished contractual provisions requiring the consent of all parties prior to surrender of a lease from a lease termination situation, and declined to imply such a provision under clauses of the JOA which required notification to all parties prior to plugging and abandonment of a well.
plugged and abandoned without the consent of all parties. Should Operator, after diligent effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after delivery of notice of the proposal to plug and abandon such well, such party shall be deemed to have consented to the proposed abandonment. All such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense of the parties who participated in the cost of drilling or Deepening such well. Any party who objects to plugging and abandoning such well by notice delivered to Operator within forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) after delivery of notice of the proposed plugging shall take over the well as of the end of such forty-eight (48) hour notice period and conduct further operations in search of Oil and/or Gas subject to the provisions of Article VI.B.; failure of such party to provide proof reasonably satisfactory to Operator of its financial capability to conduct such operations or to take over such period or thereafter to conduct operations on such well or plug and abandon such well shall entitle Operator to retain or take possession of the well and plug and abandon the well. The party taking over the well shall indemnify Operator (if Operator is an abandoning party) and the other abandoning parties against liability for any further operations conducted on such well except for the costs of plugging and abandoning the well and restoring the surface, for which the abandoning parties shall remain proportionately liable.

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

Parties taking over a well as provided herein shall tender to each of the other parties its proportionate share of the value of the well's salvable material and equipment, determined in accordance with the provisions of Exhibit "C," less the estimated cost of salvaging and the estimated cost of plugging and abandoning and restoring the surface; provided, however, that in the event the estimated plugging and abandoning and surface restoration costs and the estimated cost of salvaging are higher than the value of the well's salvable material and equipment, each of the abandoning parties shall tender to the parties continuing operations their proportionate shares of the estimated excess cost. Each abandoning party shall assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity, or fitness for use of the equipment and material, all of its interest in the wellbore of the well and related equipment, together with its interest in the Leasehold insofar and only insofar as such Leasehold covers the right to obtain production from that wellbore in the Zone then open to production. If the interest of the abandoning party is or includes an Oil and Gas Interest, such party shall execute and deliver to the non-abandoning party or parties an oil and gas lease, limited to the wellbore and the Zone then open to production, for a term of one (1) year and so long thereafter as Oil and/or Gas is produced from the Zone covered thereby, such lease to be on the form attached as Exhibit "B." The assignments or leases so limited shall encompass the Drilling Unit upon which the well is located.

The payments by, and the assignments or leases to, the assignee shall be in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all assignees. There shall be no readjustment of interests in the remaining portion of the Contract Area.

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

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

F. Termination of Operations:

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

G. Taking Production in Kind:

Option No. 1: Gas Balancing Agreement Attached

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

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

F. TERMINATION OF OPERATIONS

Previously, operations could only be terminated prematurely if impenetrable substances were encountered or if conditions in the hole were encountered which made further operations impractical in the Initial Well. In Lerblance v. Continental Oil Co., 433 F. Supp. 233 (E.D. Okla. 1976) the court held that the Operator can terminate drilling the Initial Well if it encounters impenetrable substances or conditions rendering further drilling impracticable. No mention was made of any subsequent operations. This concept was expanded to cover subsequent operations in the 1989 Form. The word "impractical" is not defined in prior JOA forms, and its definition is open to interpretation. (The phrase "operations impractical" is also used on page 7, line 20.) Arkla Exploration Co. v. Boren, 411 F.2d 879 (8th Cir. 1969) supports the proposition that the Operator can prematurely terminate drilling subsequent wells when the costs become prohibitive.

As a consequence of an addition to the 1989 Form, an operation can be ended prematurely if a to-be-determined percentage of the parties wish to terminate such operations. This provision will foreclose one participating party, who may be only a small minority interest owner, from requiring the other participating parties to pursue an operation that was previously approved but, due to unanticipated events, has become extremely expensive, although it may not be "impractical." The percentage to be inserted in the blank will be subject to negotiations and will depend on the number of parties and their proportionate ownership interest. Parties who pursuant to farmin agreements or exploration agreements need to drill to a specified distance should carefully consider the implications of this provision. Under such circumstances, it may be appropriate to delete or limit the application of Article VI.F.

G. TAKING PRODUCTION IN KIND

It is recommended that the last sentence of the first paragraph, lines 70 to 72 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
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

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. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally, and no party shall have any liability to third parties hereunder to satisfy the default of any other party in the payment of any expense or obligation hereunder. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership, joint venture, agency relationship or association, or to render the parties liable as partners, co-venturers, or principals. In their relations with each other under this agreement, the parties shall not be considered fiduciaries or to have established a confidential relationship but rather shall be free to act on an arm's-length basis in accordance with their own respective self-interest, subject, however, to the obligation of the parties to act in good faith in their dealings with each other with respect to activities hereunder.
Article VI. DRILLING AND DEVELOPMENTS

G. TAKING PRODUCTION IN KIND (continued)

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.

Several changes have been incorporated which improve the language from that of the 1982 Form. For example: (1) any purchase or sale of production by the Operator may be terminated by the giving of at least 10 days notice to the owner of production; (2) an owner of production must give the Operator at least 10 days notice before it can take production in kind, although for gas (Option No. 2), this 10 day period can be extended for a period not to exceed 90 days; (3) the Operator is not under any duty to share its market or to obtain a specific price; and (4) the sale by the Operator of a Non-Operator's production does not give the Non-Operator any right in the Operator's contract.

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 adverse tax consequences. 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.

An interesting question involves the sale of production to a subsidiary of the Operator. See Texas Oil & Gas Corp. v. Hagen, 683 S.W.2d 24 (Tex. App. 1985); citing Gentry v. Credit Plan Corp. of Houston, 528 S.W.2d 571 (Tex. 1975); Bell Oil & Gas Co. v. Allied Chemical 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 should not limit the ability of a Non-Operator to enter into a sales contract with a subsidiary of an Operator.

On a related issue, the court in Crosby - Mississippi Resources, Ltd. v. Sage Petroleum U.S. Inc., 767 F.2d 143 (5th Cir. 1985) interpreting a 1956 JOA ruled that whereas the Operator chose to purchase condensate from the Non-Operators it could do so as long as the market price for condensate was paid to the Non-Operators, which
directly from the purchaser thereof for its share of all production.

If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of 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 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. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of such sale and the party shall be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise at any time its right to take in kind, or separately dispose of, its share of all Oil not previously 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 time as are 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.

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

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

In the event one or more parties' separate disposition of its share of the Gas causes split-stream deliveries to separate pipelines and/or 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 be allocated to it, the balancing or accounting between the parties shall be in accordance with any Gas balancing agreement between the parties hereto, whether such an agreement is attached as Exhibit "E" or is a separate agreement. Operator shall give notice to all parties of the first sales of Gas from any well under this agreement.

Option No. 2: No Gas Balancing Agreement:

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

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

If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the Oil and/or Gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such Oil and/or Gas or sell it to others at any time and from time to time, for the account of the non-taking party. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of such sale and shall be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise its right to take in kind, or separately dispose of, its share of all Oil and/or Gas not previously delivered to a purchaser; provided, however, that the effective date of any such revocation may be deferred at Operator's election for a period not to exceed ninety (90) days if Operator has committed such production to a purchase contract having a term extending beyond such ten (10) day period. Any purchase or sale by Operator of any other party's share of Oil and/or Gas shall be only for such reasonable periods of time as are 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.

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

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

ARTICLE VII.

EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

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. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally, and no party shall have any liability to third parties hereunder to satisfy the default of any other party in the payment of any expense or obligation hereunder. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership, joint venture, agency relationship or association, or to render the parties liable as partners, co-venturers, or principals. In their relations with each other under this agreement, the parties shall not be considered fiduciaries or to have established a confidential relationship but rather shall be free to act on an arm's-length basis in accordance with their own respective self-interest, subject, however, to the obligation of the parties to act in good faith in their dealings with each other with respect to activities hereunder.
Article VI. DRILLING AND DEVELOPMENTS

G. TAKING PRODUCTION IN KIND (continued)

in no event could be less than the price received by the Operator. The Non-Operators contended that they should be paid based on the higher price of the refined products.

This Form includes a requirement that all parties advise the Operator in writing of their gas marketing arrangements for the following month, excluding price, and notify the Operator of any change in such arrangements. The Operator shall maintain records of all marketing arrangements including all volumes sold or transported by each party and such records shall be given to the Non-Operators upon request. Split stream deliveries shall be handled pursuant to the terms of the relevant Gas Balancing Agreement. This new provision was made necessary as a consequence of the new marketing arrangements. Operators were responsible for accounting for gas sales, but they were not contemporaneously supplied with the necessary information. Operators obtained such information from the pipelines and this information was frequently many months old. With the introduction of this new language, the Operator will be contemporaneously given such necessary information by each of the Non-Operators.

The use of Option No. 2 continues to be deceptive. It can give parties a false sense of comfort that a Gas Balancing Agreement is not necessary. All Option No. 2 does is give the Operator the right to buy the Non-Operator's oil and gas, as opposed to Option No. 1 which only gives the Operator the right to buy a Non-Operator's oil. The use of Option No. 2 is not a substitute for a Gas Balancing Agreement.

Article VII. EXPENDITURES AND LIABILITY OF PARTIES

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. Jan. 17, 1984), aff'd., No. 84-1160 (10th Cir. July 12, 1985). But see *Frontier Exploration, Inc. v. Blocker Exploration Co.*, 740 P.2d 983 (Colo. 1987); *Berchelmann*
directly from the purchaser thereof for its share of all production.

If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of 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 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. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of said sale and shall be subject always to the right of the owner of the production on the date of the occurrence of a change in such arrangements. Any party taking its share of production in kind shall be entitled to receive payment on a pro rata basis for its share of the expenses of production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment directly from the purchaser thereof for its share of all production.

If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the Oil and/or Gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such Oil and/or Gas or sell it to others at any time and from time to time, for the account of the non-taking party. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of said purchase and shall be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise at any time and from time to time, for the account of the non-taking party. A any such sale by Operator shall be in a manner commercially reasonable under the circumstances but Operator shall have no duty to share any existing market or transportation arrangement or to obtain a price or transportation fee equal to that received under any existing market or transportation arrangement. The sale or delivery by Operator of a non-taking party's share of Oil and/or Gas shall be only for such reasonable periods of time as are 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.

A. Liability of Parties:

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. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally, and no party shall have any liability to third parties hereunder to satisfy the default of any other party in the payment of any expense or obligation hereunder. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership, joint venture, agency relationship or association, or to render the parties liable as partners, co-venturers, or principals. In their relations with each other under this agreement, the parties shall not be considered fiduciaries or to have established a confidential relationship but rather shall be free to act on an arm's-length basis in accordance with their own respective self-interest, subject, however, to the obligation of the parties to act in good faith in their dealings with each other with respect to activities hereunder.

ARTICLE VII.

EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

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. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally, and no party shall have any liability to third parties hereunder to satisfy the default of any other party in the payment of any expense or obligation hereunder. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership, joint venture, agency relationship or association, or to render the parties liable as partners, co-venturers, or principals. In their relations with each other under this agreement, the parties shall not be considered fiduciaries or to have established a confidential relationship but rather shall be free to act on an arm's-length basis in accordance with their own respective self-interest, subject, however, to the obligation of the parties to act in good faith in their dealings with each other with respect to activities hereunder.
Article VII. EXPENDITURES AND LIABILITY OF PARTIES

A. LIABILITY OF PARTIES (continued)

v. Western Co., 363 S.W.2d 875 (Tex. Civ. App. 1962) (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.G. and H. 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.

This Form now clearly states that "no party shall have any liability to third parties hereunder to satisfy the default of any other party in the payment of any expense or obligation hereunder" and "the parties shall not be considered fiduciaries." Although these additions will not stop third party lawsuits which attempt to hold the Non-Operator liable for the Operator's debts, they will help.

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 XVI.M. for an example.)

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

If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of 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 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. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of said production and shall be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise at any time its right to take in kind, or separately dispose of, its share of all Oil not previously 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 time as are 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.

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

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

In the event one or more parties' separate disposition of its share of the Gas causes split-stream deliveries to separate pipelines and/or 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 be allocated to it, the balancing or accounting between the parties shall be in accordance with any Gas Balancing agreement between the parties hereto, whether such an agreement is attached as Exhibit "E" or is a separate agreement. Operator shall give notice to all parties of the first sales of Gas from any well under this agreement.

Option No. 2: No Gas Balancing Agreement:

Each party shall take in kind or separately dispose of its proportionate share of all Oil and Gas produced from the Contract Area, exclusive of production which may be used in development and producing operations and in preparing and treating Oil and Gas for marketing purposes and production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate disposition by any 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 required to pay for only its proportionate share of such party's surface facilities which it uses. Each party shall execute such division orders and contracts as may be necessary for the sale of its interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled to receive payment directly from the purchaser thereof for its share of all production.

If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the Oil and/or Gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such Oil and/or Gas or sell it to others at any time and from time to time, for the account of the non-taking party. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of said production and shall be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise at any time its right to take in kind, or separately dispose of, its share of all Oil and/or Gas not previously delivered to a purchaser; provided, however, that the effective date of any such revocation may be deferred at Operator's election for a period not to exceed ninety (90) days if Operator has committed such production to a purchase contract having a term extending beyond such ten (10) day period. Any purchase or sale by Operator of any other party's share of Oil and/or Gas shall be only for such reasonable periods of time as are 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.

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

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

ARTICLE VII.

EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

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. Accordingly, the liens granted among the parties in Article VII.B. are given to secure only the debts of each severally, and no party shall have any liability to third parties hereunder to satisfy the default of any other party in the payment of any expense or obligation hereunder. It is not the intention of the parties to create, nor shall this agreement be construed as creating, a mining or other partnership, joint venture, agency relationship or association, or to render the parties liable as partners, co-venturers, or principals. In their relations with each other under this agreement, the parties shall not be considered fiduciaries or to have established a confidential relationship but rather shall be free to act on an arm's-length basis in accordance with their own respective self-interest, subject, however, to the obligation of the parties to act in good faith in their dealings with each other with respect to activities hereunder.
Article VII. EXPENDITURES AND LIABILITY OF PARTIES

A. LIABILITY OF PARTIES (continued)

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. See Rankin v. Naftalis, 557 S.W.2d 940 (Tex. 1977) (the court ruled that there was a duty to share leases acquired within the Contract Area); Foley v. Phillips, 508 P.2d 975 (Kan. 1973) (the court held that the duty to share depended on the scope of the enterprise).

A fair amount of litigation has involved the issue of whether a Non-Operator is liable under the JOA for debts incurred by the Operator to contractors who have conducted work for the Joint Account. Robert Bledsoe in an article addressing the JOA and Non-Operators concludes that the Non-Operator should not be liable for such debts because no privity of contract exists between the contractor and the Non-Operator. Bledsoe, Operating Agreements From the Standpoint of the Non-Operator, LANDMAN, Mar.-Apr., 1988.

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. 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
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

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

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

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

If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the Oil and/or Gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such Oil and/or Gas or sell it to others at any time and from time to time, for the account of the non-taking party. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of said production and shall be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise at any time its right to take in kind, or separately dispose of, its share of all Oil or Gas not previously delivered to a purchaser; provided, however, that the effective date of any such revocation may be deferred at Operator's election for a period not to exceed ninety (90) days if Operator has committed such production to a purchase contract having a term extending beyond such ten (10) day period. Any purchase or sale by Operator of any other party's share of Oil and/or Gas shall be only for such reasonable periods of time as are 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.

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

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Article VII. EXPENDITURES AND LIABILITY OF PARTIES

A. LIABILITY OF PARTIES (continued)

partnership. Later in 1968, the court reversed itself and held that because the agreement was induced by fraud, a fiduciary relationship existed, notwithstanding mining language that unambiguously negated such result. Oklahoma Co. v. O'Neil, 333 P.2d 534 (Okla. 1958), mandate recalled and dec. vacated, 431 P.2d 445 (Okla. 1967), new op. issued, 440 P.2d 978 (Okla. 1968). More recently, courts in Oklahoma have characterized the Operator's relationship to the Non-Operator as a trustee type relationship, and consequently, the courts have imposed a fiduciary relationship. See Reserve Oil, Inc. v. Dixon, 711 F.2d 951 (10th Cir. 1983); In re Mahan & Rowsey, Inc., 35 Bankr. 898 (Bankr. W.D. Okla. 1983). See also Prentice v. Amax Petroleum Corp., 220 So.2d 783 (La. Ct. App. 1969), cert. denied, 455, 223 So.2d 867 (La. 1969), (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 directly 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 "[c]ourts 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."

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. More recently, in True Oil Co. v. Sinclair Oil Corp., 771 P.2d 781 (Wyo. 1981) the court spoke in terms of a fiduciary duty, but only imposed on the Operator an obligation to obtain drilling and related services at a reasonable cost as reflected by competitive rates. The Operator
directly from the purchaser thereof for its share of all production.

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ARTICLE VII.
EXPENDITURES AND LIABILITY OF PARTIES

A. Liability of Parties:

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Article VII. EXPENDITURES AND LIABILITY OF PARTIES

A. LIABILITY OF PARTIES (continued)

did not violate its duty by using an affiliated company who earned a profit for the work undertaken. In Beadle v. Daniels, 362 P.2d 128 (Wyo. 1961), the court held that an Operator could not charge the venture the fair market price of equipment purchased below that price. Section II.8 of the accounting provision should be examined to ensure consistency with the JOA. See COPAS Interpretation #16 (Oct. 22, 1986).

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 Parvin v. Davis Oil Co., 655 F.2d 901 (9th Cir. 1979), cert. denied 445 U.S. 965 (1980); 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); Cross v. Paley, 270 F.2d 88 (8th Cir. 1959) cert. denied 362 U.S. 902 (1960). But see Vicioso v. Watson, 325 F. Supp. 1071 (C.D. Cal. 1971). Due to the difficulties of providing for every intended limitation on an Operator's fiduciary duty, parties wishing to negate fiduciary liability could expressly 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).

Howard Boigan in his article Liabilities and Relations of Co-Owners Under Agreements for Joint Development of Oil and Gas Properties, Southwestern Legal Foundation, 37th Annual Institute on Oil and Gas Law Taxation, contends that the typical JOA contains all the indicia of mining partnerships or joint ventures. The JOA argues Boigan "goes far beyond the provision for passive sharing of production and the bearing of expenses that are inherent in any cotenancy in the absence of agreement; it establishes instead an interlocking web of mutual rights and responsibilities envisioning a concerted effort in the development of an oil and gas property."

The Supreme Courts of Arkansas and Oklahoma found a joint venture relationship to exist where the Operator engaged in self dealing. In Texas Oil and Gas Corp. v. Hawkins Oil & Gas Inc., 688 S.W.2d 16 (Ark. 1984), Texas Oil and Gas Corporation as Operator in the process of preparing a drilling title opinion discovered that Hawkins Oil and Gas Inc., a Non-Operator, had taken a lease from the wrong party. Texas Oil and Gas then proceeded to acquire leases from the proper parties for its account without notifying Hawkins. The Arkansas Supreme court found that the
directly from the purchaser thereof for its share of all production.

If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of 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 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. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of said production and shall be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise its right to take in kind, or separately dispose of, its share of all Oil not previously 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 time as are 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.

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

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

In the event one or more parties' separate disposition of its share of the Gas causes split-stream deliveries to separate pipelines and/or 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 be allocated to it, the balancing or accounting between the parties shall be in accordance with any Gas balancing agreement between the parties hereto, whether such an agreement is attached as Exhibit "E" or is a separate agreement. Operator shall give notice to all parties of the first sales of Gas from any well under this agreement.

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

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

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

If any party fails to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the Oil and/or Gas produced from the Contract Area, Operator shall have the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such Oil and/or Gas or sell it to others at any time and from time to time, for the account of the non-taking party. Any such purchase or sale by Operator may be terminated by Operator upon at least ten (10) days written notice to the owner of said production and shall be subject always to the right of the owner of the production upon at least ten (10) days written notice to Operator to exercise its right to take in kind, or separately dispose of, its share of all Oil and/or Gas not previously delivered to a purchaser; provided, however, that the effective date of any such revocation may be deferred at Operator's election for a period not to exceed ninety (90) days if Operator has committed such production to a purchase contract having a term extending beyond such ten (10) day period. Any purchase or sale by Operator of any other party's share of Oil and/or Gas shall be only for such reasonable periods of time as are 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.

Any such sale by Operator shall be in a manner commercially reasonable under the circumstances, but Operator shall have no duty to share any existing market or transportation arrangement or to obtain a price or transportation fee equal to that received under any existing market or transportation arrangement. The sale or delivery by Operator of a non-taking party's share of Oil under the terms of any existing contract of Operator shall not give the non-taking party any interest in or make the non-taking party a party to said contract. No purchase of Oil and Gas and no sale of Gas shall be made by Operator without first giving the non-taking party ten (10) days written notice of such intended purchase or sale and the price to be paid or the pricing basis to be used. Operator shall give notice to all parties of the first sale of Gas from any well under this Agreement.

All parties shall give timely written notice to Operator of their Gas marketing arrangements for the following month, excluding price, and shall notify Operator immediately in the event of a change in such arrangements.

Operator shall maintain records of all marketing arrangements, and of volumes actually sold or transported, which records shall be made available to Non-Operators upon reasonable request.
Article VII. EXPENDITURES AND LIABILITY OF PARTIES

A. LIABILITY OF PARTIES (continued)

JOA was "sufficiently similar to a partnership to constitute a joint venture" and held that as a consequence of the fiduciary duty Texas Oil and Gas held one-half of the lease in trust for Hawkins. See Bank of Nova Scotia v. Société Générale (Canada), 58 Alta. L.R.2d 193; 87 A.R. 133 (C.A.) (1988). But see Prentice v. Amax Petroleum Corp., 220 So.2d 783 (La. App.), cert. denied, 223 So.2d 867 (La. 1969).

In Oklahoma Co. v. O'Neil, 440 P.2d 978 (Okla. 1968), the Oklahoma Supreme Court permitted Non-Operators to rescind the acquisition of their leasehold interests from the Operator where the Operator was found to have engaged in fraud. The court held that notwithstanding the JOA's disclaimer of a partnership, the parties had created a joint venture and the Operator's fraud negated the contractual disclaimer that no partnership existed. The Western District Court, interpreting Oklahoma law, held in Tenneco Oil Co. v. Bogert, 630 F. Supp. 961 (W.D Okla. 1986) that the JOA imposed no fiduciary duty which obligated the Operator to drill an additional well simply because it had knowledge of drainage by a well it had drilled on an adjacent track. See also Withrow v. Red Eagle Oil Co., 755 P.2d 622 (1988).

The Texas Supreme Court in a somewhat ambiguous decision held that the JOA created a limited joint venture. Rankin v. Naftalis, 557 S.W.2d 940 (Tex. 1977). Rankin has been cited to support the proposition that a joint venture or partnership does not exist or exists only in very narrow terms. See Jeanes v. Henderson, 703 F.2d 855, 858 (5th Cir. 1983); Hamilton v. Texas Oil & Gas Corp., 648 S.W.2d 316 (Tex. Civ. App. 1982). But see Jeanes v. Henderson, 703 F.2d 855 (5th Cir. 1983); Fesqua v. Taylor, 683 S.W.2d 735 (Tex. Civ. App. 1984) Colorado has followed Texas. See Frontier Exploration, Inc. v. Blocker Exploration Co., 709 P.2d (Colo. App. June 6, 1985), cert. pending.

The Kansas Supreme Court has found the existence of a joint venture in the concept of a JOA. Foley v. Phillips, 211 Kan. 735, 508 P.2d 975 (1973); First National Bank & Trust Co. v. Tri-State Pipe Co., 197 Kan. 163, 415 P.2d 377 (1966). Likewise, the Tenth Circuit has found a trust relationship. Reserve Oil v. Dixon, 711 F.2d 951 (10th Cir. 1983); Britton v. Green, 325 F.2d 377 (10th Cir. 1983).

Courts have found Non-Operators liable for the debts incurred by the Operator where the Non-Operators participated in operations or cooperated in the management and control of the activities. See Dresser Industries, Inc. v. Crystal Exploration and Production Co., No. 83-1275-W (D. Okla. Jan. 17, 1984), aff'd.
B. Liens and Security Interests:

Each party agrees that the other parties shall be entitled to utilize the provisions of Oil and Gas lien law or other lien law of any state in which the Contract Area is situated to enforce the obligations of each party hereunder. Without limiting the generality of the foregoing, to the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the mechanics’ or materialmen’s lien law of the state in which the Contract Area is situated in order to secure the payment to Operator of any sum due hereunder for services performed or materials supplied by Operator.

C. Advances:

Operator, at its election, shall have the right from time to time to demand and receive from one or more of the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice, for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month.

Each party shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such estimate and for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month, which right may be exercised only by submission to each such party of an invoice is received. If any party fails to pay its share of cost within one hundred twenty (120) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid by each party so paying its share of the unpaid amount shall be secured by the liens and security rights described in Article VII.B., and each paying party may independently pursue any remedy available hereunder or otherwise.

If any party does not perform all of its obligations hereunder, and the failure to perform subjects such party to foreclosure or execution proceedings pursuant to the provisions of this agreement, to the extent allowed by governing law, the defaulting party waives any available right of redemption from and after the date of judgment, any required valuation or appraisal of the mortgaged or secured property prior to sale, any available right to stay execution or to require a marshalling of assets and any required bond in the event a receiver is appointed. In addition, to the extent permitted by applicable law, each party hereby grants to the other parties a power of sale as to any property that is subject to the lien and security rights granted hereunder, such power to be exercised in the manner provided by applicable law or otherwise in a commercially reasonable manner and upon reasonable notice.

Each party agrees that the other parties shall be entitled to utilize the provisions of Oil and Gas lien law or other lien law of any state in which the Contract Area is situated to enforce the obligations of each party hereunder. Without limiting the generality of the foregoing, to the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the mechanics’ or materialmen’s lien law of the state in which the Contract Area is situated in order to secure the payment to Operator of any sum due hereunder for services performed or materials supplied by Operator.

D. Defaults and Remedies:

If any party fails to discharge any financial obligation under this agreement, including without limitation the failure to make any advance under the provisions of this agreement, within the period required for such payment hereunder, then in addition to the remedies provided in Article VII.B. or elsewhere in this agreement, the remedies specified below shall be applicable. For purposes of this Article VII.D., all notices and elections shall be delivered
Article VII. EXPENDITURES AND LIABILITY OF PARTIES

A. LIABILITY OF PARTIES (continued)

No. 84-1160 (10th Cir. July 12, 1985); West v. Kerr-McGee Corp., 586 F. Supp. 493 (E.D. La. 1984), rev'd on other grounds, 765 F.2d 526 (5th Cir. 1983); But see Transcontinental Gas Pipeline Corp. v. Mr. Charlie, 294 F. Supp. 1025 (E.D. La. 1968) rev'd on other grounds 424 F.2d 684 (5th Cir.); cert. denied 400 U.S. 832 (1970). In Blocker Exploration Co. v. Frontier Exploration, Inc., 740 P.2d 983 (Colo. 1987), the Colorado Supreme Court ruled that a Non-Operator was not liable for the debts of the Operator where the Non-Operator only had the right to receive reports, inspect books, elect to join in subsequent operations and approve specified expenditures.

B. LIENS AND SECURITY INTERESTS

This provision has been greatly expanded and improved over the 1982 Form. The lien now covers both present and future acquired real and personal property. The provision now expansively lists the property rights covered by the lien and security interest. 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. Moreover, each party now represents that the lien and security interest granted shall be a first and prior lien and that the party will maintain the priority of such lien and security interest. 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, 691 S.W.2d 851 (Ark. 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 miner's 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. CODE ANN. PROP. CODE, §§ 56.001-56.003 (Vernon 1984)) extends to the Operator, because the
B. Liens and Security Interests:

1. Each party grants to the other parties hereeto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest and/or purchase money security interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith, to secure performance of all of its obligations under this agreement including but not limited to payment of expense, interest and fees, the proper disbursement of all monies paid hereunder, the assignment or relinquishment of interest in Oil and Gas Leases as required hereunder, and the proper performance of operations hereunder. Such lien and security interest granted by each party hereeto shall include such party’s leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the Contract Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject to this agreement, the Oil and Gas when extracted therefrom and equipment situated thereon or used or obtained for use in connection therewith (including, without limitation, all wells, tools, and tubular goods), and accounts (including, without limitation, accounts arising from gas imbalances or from the sale of Oil and/or Gas at the wellhead), contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of the foregoing.

2. To perfect the lien and security agreement provided herein, each party hereto shall execute and acknowledge the recording supplement and/or any financing statement prepared and submitted by any party hereto in conjunction herewith or at any time following execution hereof, and Operator is authorized to file this agreement or the recording supplement executed herewith as a lien or mortgage in the applicable real estate records and as a financing statement with the proper officer under the Uniform Commercial Code in the state in which the Contract Area is situated and such other states as Operator shall deem appropriate to perfect the security interest granted hereunder. Any party may file this agreement, the recording supplement executed herewith, or such other documents as it deems necessary as a lien or mortgage in the applicable real estate records and/or a financing statement with the proper officer under the Uniform Commercial Code.

3. Each party represents and warrants to the other parties hereto that the lien and security interest granted by such party to the other parties shall be a first and prior lien, and each party hereby agrees to maintain the priority of said lien and security interest against all persons acquiring an interest in Oil and Gas Leases and Interests covered by this agreement by, through or under such party. All parties acquiring an interest in Oil and Gas Leases and Oil and Gas Interests covered by this agreement, whether by assignment, merger, mortgage, operation of law, or otherwise, shall be deemed to have taken subject to the lien and security interest granted by this Article VII.B. as to all obligations attributable to such interest hereunder whether or not such obligations arise before or after such interest is acquired.

4. To the extent that parties have a security interest under the Uniform Commercial Code of the state in which the Contract Area is situated, they shall be entitled to exercise the rights and remedies of a secured party under the Code.

5. The bringing of a suit and the obtaining of judgment by a party for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any party in the payment of its share of expenses, interests or fees, or upon the improper use of funds by the Operator, the other parties shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting party’s share of Oil and Gas until the amount owed by such party, plus interest as provided in “Exhibit C,” has been received, and shall have the right to offset the amount owed against the proceeds from the sale of such defaulting party’s share of Oil and Gas. All purchasers of production may rely on a notification of default from the non-defaulting party or parties stating the amount due as a result of the default, and all parties waive any recourse available against purchasers for releasing production proceeds as provided in this paragraph.

6. If any party fails to pay its share of cost within one hundred twenty (120) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid by each party so paying its share of the unpaid amount shall be secured by the lien and security rights described in Article VII.B., and each paying party may independently pursue any remedy available hereunder or otherwise.

7. If any party does not perform all of its obligations hereunder, and the failure to perform subjects such party to foreclosure or execution proceedings pursuant to the provisions of this agreement, to the extent allowed by governing law, the defaulting party expressly waives any available right of redemption from and after the date of judgment any required valuation or appraisement of the mortgaged or secured property prior to sale, any available right to stay execution or to require a marshalling of assets and any required bond in the event a receiver is appointed. In addition, to the extent permitted by applicable law, each party hereby grants to the other parties a power of sale as to any property that is subject to the lien and security rights granted hereunder, such power to be exercised in the manner provided by applicable law or otherwise in a commercially reasonable manner and upon reasonable notice.

8. Each party agrees that the other parties shall be entitled to utilize the provisions of Oil and Gas lien law or other lien law of any state in which the Contract Area is situated to enforce the obligations of each party hereunder. Without limiting the generality of the foregoing, to the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the mechanics’ or materialmen’s lien law of the state in which the Contract Area is situated in order to secure the payment to Operator of any sum due hereunder for services performed or materials supplied by Operator.

C. Advances:

1. Operator, at its election, shall have the right from time to time to demand and receive from one or more of the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month.

2. Each party shall pay to Operator its proportionate share of such estimate within 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 due shall bear interest as provided in Exhibit “C” until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Defaults and Remedies:

1. If any party fails to discharge any financial obligation under this agreement, including without limitation the failure to make any advance under the preceding Article VII.B. or any provision of this agreement, within the period required for such payment hereunder, then in addition to the remedies provided in Article VII.B. or elsewhere in this agreement, the remedies specified below shall be applicable. For purposes of this Article VII.D., all notices and elections shall be delivered...
Article VII. EXPENDITURES AND LIABILITIES OF PARTIES

B. LIENS AND SECURITY INTERESTS (continued)

Operator is the person with whom the contract with the mechanic or materialman 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 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. 1979, writ granted); *Sanguinett & Statts v. Colorado Salt Co.*, 150 S.W. 490 (Tex. Civ. App. 1912) the court held that engineers and architects who contribute services in construction projects are protected by the general mechanic's and materialman'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 "[A]bsent 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. 1922) 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. 1923) 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.

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 (1972)) secures amounts owed by Non-Operators to Operator. *Kenmore Oil Co. v. Delacroix*, 316 So.2d 468 (La. Ct. App. 1975). The Mississippi statutory lien (MIS. CODE ANN. § 85-7-131 (1972)) expressly grants the Operator a statutory lien. *See also OKLA. STAT. tit. 42, § 144.2 (Supp. 1986) which requires operators, contractors and subcontractors who receive funds payable under a JOA, drilling contract or reworking contract or as a condition of participation under an Oklahoma Corporation Commission pooling order to hold such funds as "trust funds" for the payment of all lienable claims as they become due. While the statutory lien will probably protect an Operator in Oklahoma and Kansas it likely will not protect an Operator in Illinois. In *Amarex, Inc. v. El Paso Natural Gas Co.*, 772 P.2d 905 (1987), the Oklahoma Supreme Court effectively overruled the long standing decision of *Uncle Sam Oil Co. v. Richards*, 158 P. 1187 (Okla. 1916) and held that although the filing of the JOA is the preferred method of perfection of an oil and gas lien a Memorandum of Operating Agreement and Financing Statement would suffice.
B. Liens and Security Interests:

Each party grants to the other parties hereto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest in and/or purchase money security interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith, to secure performance of all of its obligations under this agreement including but not limited to payment of expense, interest and fees, the proper disbursement of all monies paid hereunder, the assignment or relinquishment of interest in Oil and Gas Leases as required hereunder, and the proper performance of operations hereunder. Such lien and security interest granted by each party hereto shall include such party’s leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the Contract Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject to this agreement, the Oil and Gas when extracted therefrom and equipment situated thereon or used or obtained for use in connection therewith (including, without limitation, all wells, tools, and tubular goods), and accounts (including, without limitation, accounts arising from gas imbalances or from the sale of Oil and/or Gas at the wellhead), contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of the foregoing.

To perfect the lien and security agreement provided herein, each party hereto shall execute and acknowledge the recording supplement and/or any financing statement prepared and submitted by any party hereto in conjunction herewith or at any time following execution hereof, and Operator is authorized to file this agreement or the recording supplement executed herewith as a lien or mortgage in the applicable real estate records and as a financing statement with the proper officer under the Uniform Commercial Code in the state in which the Contract Area is situated and such other states as Operator shall deem appropriate to perfect the security interest granted hereunder. Any party may file this agreement, the recording supplement executed herewith, or such other documents as it deems necessary as a lien or mortgage in the applicable real estate records and/or a financing statement with the proper officer under the Uniform Commercial Code.

Each party represents and warrants to the other parties hereto that the lien and security interest granted by such party to the other parties shall be a first and prior lien, and each party hereby agrees to maintain the priority of said lien and security interest against all persons acquiring an interest in Oil and Gas Leases and Interests covered by this agreement by, through or under such party. All parties acquiring an interest in Oil and Gas Leases and Oil and Gas Interests covered by this agreement, whether by assignment, merger, mortgage, operation of law, or otherwise, shall be deemed to have taken subject to the lien and security interest granted by this Article VII.B. as to all obligations attributable to such interest hereunder whether or not such obligations arise before or after such interest is acquired.

To the extent that parties have a security interest under the Uniform Commercial Code of the state in which the Contract Area is situated, they 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 a party for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any party in the payment of its share of expenses, interests or fees, or upon the improper use of funds by the Operator, the other parties shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting party’s share of Oil and Gas until the amount owed by such party, plus interest as provided in “Exhibit C,” has been received, and shall have the right to offset the amount owed against the proceeds from the sale of such defaulting party’s share of Oil and Gas. All purchasers of production may rely on a notification of default from the non-defaulting party or parties stating the amount due as a result of the default, and all parties waive any recourse available against purchasers for releasing production proceeds as provided in this paragraph.

If any party fails to pay its share of cost within one hundred twenty (120) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid by each party so paying its share of the unpaid amount shall be secured by the liens and security rights described in Article Article VII.B., and each paying party may independently pursue any remedy available hereunder or otherwise.

If any party does not perform all of its obligations hereunder, and the failure to perform subjects such party to foreclosure or execution proceedings pursuant to the provisions of this agreement, to the extent allowed by governing law, the defaulting party waives any available right of redemption from and after the date of judgment, any required valuation or appraisement of the mortgaged or secured property prior to sale, any available right to stay execution or to require a marshalling of assets and any required bond in the event a receiver is appointed. In addition, to the extent permitted by applicable law, each party hereby grants to the other parties a power of sale as to any property that is subject to the lien and security rights granted hereunder, such power to be exercised in the manner provided by applicable law or otherwise in a commercially reasonable manner and upon reasonable notice.

Each party agrees that the other parties shall be entitled to utilize the provisions of Oil and Gas lien law or other lien law of any state in which the Contract Area is situated to enforce the obligations of each party hereunder. Without limiting the generality of the foregoing, to the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the mechanics’ or materialmen’s lien law of the state in which the Contract Area is situated in order to secure the payment to Operator of any sum due hereunder for services performed or materials supplied by Operator.

C. Advances:

Operator, at its election, shall have the right from time to time to demand and receive from one or more of the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within 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 due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Defaults and Remedies:

If any party fails to discharge any financial obligation under this agreement, including without limitation the failure to make any advance under the preceding Article VII.C., then in addition to any remedies provided in this agreement, any such party shall, after the period required for such payment hereunder, then in addition to the remedies provided in Article VII.B. or elsewhere in this agreement, the remedies specified below shall be applicable. For purposes of this Article VII.D., all notices and elections shall be delivered
Article VII. EXPENDITURES AND LIABILITY OF PARTIES

B. LIENS AND SECURITY INTERESTS (continued)

Moreover, the court ruled that the Oklahoma statutory oil and gas lien is available to the Operator, and is enforceable against the owner of the leasehold interest, if the Operator follows the requirements of the statute and that the Operator's managerial functions qualify as labor within the statute. In DaMac Drilling, Inc., v. Shoemake, 713 P.2d 480 (Kan. App. 1986) the court held that the services of a professional on-site geologist constituted lienable labor, despite the fact that the labor involved was mental rather than manual or physical labor. But see Davis v. Sherman, 149 Kan. 104, 86 P.2d 490 (1939); Gaudreau v. Smith, 21 P.2d 330 (Kan. 1933); Kinne v. Duncan, 43 N.E.2d 425 (Ill. App. 1942).

In an effort to overcome these difficulties, this Form provides that each party agrees that all other parties shall be entitled to utilize the state's oil and gas lien law and related statutes and that the Operator may utilize the mechanic's or materialman's lien law. If these undertakings are successful, creditors will have as much position in attempting to satisfy debts due from other parties to the JOA.

Rather than rely on a judicial interpretation that the state's statutory lien provides creditor parties with priority and security, the parties should file the JOA of record or file a Memorandum of Operating Agreement and Financing Statement, perfecting a security interest under the Uniform Commercial Code or file 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 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 XVI.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. To ensure the execution of a Memorandum of Operating Agreement and Financing Statement, the Form states that each party agrees to execute and acknowledge the necessary lien and financing statement documents. The lien and financing statement should be executed contemporaneously with the JOA and filed of record soon thereafter. However, in MBank Abilene, N.A. v. Westwood Energy, Inc., 723 S.W.2d 246 (Tex. Ct. App. 1986) the court held that the bank was deemed to have notice of an unrecovered JOA which was referred to in a document in the chain of title that was of record.

Note that the lien and security interest granted are characterized as "first and prior
B. Liens and Security Interests:

Each party grants to the other parties hereinto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest and/or purchase money security interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith, to secure performance of all of its obligations under this agreement including but not limited to payment of expense, interest and fees, the proper disbursement of all monies paid hereunder, the assignment or relinquishment of interest in Oil and Gas Leases as required hereunder, and the proper performance of operations hereunder. Such lien and security interest granted by each party hereinto shall include such party's leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the Contract Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject to this agreement, the Oil and Gas when extracted therefrom and equipment situated thereon or used or obtained for use in connection therewith (including, without limitation, all wells, tools, and tubular goods), and accounts (including, without limitation, accounts arising from gas imbalances or from the sale of Oil and/or Gas at the wellhead), contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of the foregoing.

To perfect the lien and security agreement provided herein, each party hereto shall execute and acknowledge the recording supplement and/or any financing statement prepared and submitted by any party hereto in conjunction herewith or at any time following execution hereof, and Operator is authorized to file this agreement or the recording supplement executed herewith as a lien or mortgage in the applicable real estate records and as a financing statement with the proper officer under the Uniform Commercial Code in the state in which the Contract Area is situated and such other states as Operator shall deem appropriate to perfect the security interest granted hereunder. Any party may file this agreement, the recording supplement executed herewith, or such other documents as it deems necessary as a lien or mortgage in the applicable real estate records and/or a financing statement with the proper officer under the Uniform Commercial Code.

Each party represents and warrants to the other parties hereto that the lien and security interest granted by such party to the other parties shall be a first and prior lien, and each party hereby agrees to maintain the priority of said lien and security interest against all persons acquiring an interest in Oil and Gas Leases and Interests covered by this agreement by, through or under such party. All parties acquiring an interest in Oil and Gas Leases and Oil and Gas Interests covered by this agreement, whether by assignment, merger, mortgage, operation of law, or otherwise, shall be deemed to have subject to the lien and security interest granted by this Article VII.B. as to all obligations attributable to such interest hereunder whether or not such obligations arise before or after such interest is acquired.

To the extent that parties have a security interest under the Uniform Commercial Code of the state in which the Contract Area is situated, they 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 a party for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any party in the payment of its share of expenses, interest or fees, or upon the improper use of funds by the Operator, the other parties shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting party's share of Oil and Gas until the amount owed by such party, plus interest as provided in "Exhibit C," has been received, and shall have the right to offset the amount owed against the proceeds from the sale of such defaulting party's share of Oil and Gas. All purchasers of production may rely on a notification of default from the non-defaulting party or parties stating the amount due as a result of the default, and all parties waive any recourse available against purchasers for releasing production proceeds as provided in this paragraph.

If any party fails to pay its share of cost within one hundred twenty (120) days after rendition of a statement hereof by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid by each party so paying its share of the unpaid amount shall be secured by the liens and security rights described in Article VII.B., and each paying party may independently pursue any remedy available hereunder or otherwise.

If any party does not perform all of its obligations hereunder, and the failure to perform subjects such party to foreclosure or execution proceedings pursuant to the provisions of this agreement, to the extent allowed by governing law, the defaulting party shall waive any available right of redemption from and after the date of judgment, any required valuation or appraisement of the mortgaged or secured property prior to sale, any available right to stay execution or to require a marshalling of assets and any required bond in the event a receiver is appointed. In addition, to the extent permitted by applicable law, each party hereby grants to the other parties a power of sale as to any property that is subject to the lien and security rights granted hereunder, such power to be exercised in the manner provided by applicable law or otherwise in a commercially reasonable manner and upon reasonable notice.

Each party agrees that the other parties shall be entitled to utilize the provisions of Oil and Gas lien law or other lien law of any state in which the Contract Area is situated to enforce the obligations of each party hereunder. Without limiting the generality of the foregoing, to the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the mechanics' or materialmen's lien law of the state in which the Contract Area is situated in order to secure the payment to Operator of any sum due hereunder for services performed or materials supplied by Operator.

C. Advances:

Operator, at its election, shall have the right from time to time to demand and receive from one or more of the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within 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 due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Defaults and Remedies:

If any party fails to discharge any financial obligation under this agreement, including without limitation the failure to make any advance under the preceding Article VII.D. for any period required for such payment hereunder, then in addition to the remedies provided in Article VII.B. or elsewhere in this agreement, the remedies specified below shall be applicable. For purposes of this Article VII.D., all notices and elections shall be delivered...
Article VII. EXPENDITURES AND LIABILITY OF PARTIES

B. LIENS AND SECURITY INTERESTS (continued)

liens." In conjunction with the filing of a Memorandum of Operating Agreement and Financing Statement, this sentence should eliminate conflicts that have arisen between mortgagees and the parties to the JOA and first purchasers as to where the proceeds should be paid when a party who has mortgaged its interest defaults on its loan. The parties to the JOA should come before all other creditors.

Operators may take comfort in their 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. The 1989 Form strengthens the ability of a party to collect proceeds directly from a purchaser by explicitly stating that all "purchases of production may rely on a notification of default from the non-defaulting party or parties stating the amount due as a result of the default, and all parties waive any recourse available against purchasers for releasing production proceeds. . . ." In Estate of Jackson v. Phillips Petroleum Co., 676 F. Supp. 1142 (S.D. Ala. 1987) the purchaser paid the proceeds to the Operator as requested. In this case, the Operator collected substantially more money than was in default and punitive damages were imposed against the Operator.

As a consequence of an addition included in this Form, non-defaulting parties can, by taking production or the proceeds of production, offset any amounts owed by a defaulting party. This explicit offset right is important from a bankruptcy perspective, as many states have statutes that limit the use of offsets. This self-help provision can provide real relief, assuming of course a successful well has been drilled. In In re Buttes Resources Co., 89 Bankr. 613 (S.D. Tex. 1988) the federal district court affirmed a bankruptcy order which stated that an Operator's claim against a bankrupt Non-Operator is one for recoupment rather than setoff (offset) where the claim arises from the same transaction as the debtor's claim for proceeds of sale of Oil and Gas. A setoff (offset) differs from a recoupment, the court ruled, in that it arises out of a transaction different from the one sued on.

In addition to self-help, it may be possible to exploit third-party indemnity agreements. In Terra Resources, Inc. v. Peninsula Resources Corp., 504 So.2d 608 (1987), the court permitted the Operator to recover a Non-Operator's debt from an indemnitor who was not a party to the JOA, but had agreed on the indemnity
B. Liens and Security Interests:

Each party grants to the other parties hereunto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest and/or purchase money security interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith, to secure performance of all of its obligations under this agreement including but not limited to payment of expense, interest and fees, the proper disbursement of all monies paid hereunder, the assignment or relinquishment of interest in Oil and Gas Leases as required hereunder, and the proper performance of operations hereunder. Such lien and security interest granted by each party hereto shall include such party's leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the Contract Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject to this agreement, the Oil and Gas when extracted therefrom and equipment situated thereon or used or obtained for use in connection therewith (including, without limitation, all wells, tools, and tubular goods), and accounts (including, without limitation, accounts arising from gas imbalances or from the sale of Oil and/or Gas at the wellhead), contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of the foregoing.

To perfect the lien and financing agreement provided herein, each party hereto shall execute and acknowledge the recording supplement and/or any financing statement prepared and submitted by any party hereto in conjunction herewith or at any time following execution hereof, and Operator is authorized to file this agreement or the recording supplement executed herewith as a lien or mortgage in the applicable real estate records and/or a financing statement with the proper officer under the Uniform Commercial Code in the state in which the Contract Area is situated and such other states as Operator shall deem appropriate to perfect the security interest granted hereunder. Any party may file this agreement, the recording supplement executed herewith, or such other documents as it deems necessary as a lien or mortgage in the applicable real estate records and/or a financing statement with the proper officer under the Uniform Commercial Code.

Each party represents and warrants to the other parties hereto that the lien and security interest granted by such party to the other parties shall be a first and prior lien, and each party hereby agrees to maintain the priority of said lien and security interest against all persons acquiring an interest in Oil and Gas Leases and Interests covered by this agreement by, through or under such party. All parties acquiring an interest in Oil and Gas Leases and Oil and Gas Interests covered by this agreement, whether by assignment, merger, mortgage, operation of law, or otherwise, shall be deemed to have taken subject to the lien and security interest granted by this Article VII.B. as to all obligations attributable to such interest hereunder whether or not such obligations arise before or after such interest is acquired.

To the extent that parties have a security interest under the Uniform Commercial Code of the state in which the Contract Area is situated, they 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 a party for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any party in the payment of its share of expenses, interests or fees, or upon the improper use of funds by the Operator, the other parties shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting party's share of Oil and Gas until the amount owed by such party, plus interest as provided in "Exhibit C," has been received, and shall have the right to offset the amount owed against the proceeds from the sale of such defaulting party's share of Oil and Gas. All purchasers of production may rely on a notification of default from the non-defaulting party or parties stating the amount due as a result of the default, and all parties waive any recourse available against purchasers for releasing production proceeds as provided in this paragraph.

If any party fails to pay its share of cost within one hundred twenty (120) days after rendition of a statement therefor by the Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid by each party so paying its share of the unpaid amount shall be secured by the liens and security rights described in Article VII.B., and each paying party may independently pursue any remedy available hereunder or otherwise.

If any party does not perform all of its obligations hereunder, and the failure to perform subjects such party to foreclosure or execution proceedings pursuant to the provisions of this agreement, to the extent allowed by governing law, the defaulting party may waive any available right of redemption from and after the date of judgment, any required valuation or appraisement of the mortgaged or secured property prior to sale, any available right to stay execution or to require a marshalling of assets and any required bond in the event a receiver is appointed. In addition, to the extent permitted by applicable law, each party hereby grants to the other parties a power of sale as to any property that is subject to the lien and security rights granted hereunder, such power to be exercised in the manner provided by applicable law or otherwise in a commercially reasonable manner and upon reasonable notice.

Each party agrees that the other parties shall be entitled to utilize the provisions of Oil and Gas lien law or other lien law of any state in which the Contract Area is situated to enforce the obligations of each party hereunder. Without limiting the generality of the foregoing, to the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the mechanics' or materialmen's lien law of the state in which the Contract Area is situated in order to secure the payment to Operator of any sum due hereunder for services performed or materials supplied by Operator.

C. Advances:

Operator, at its election, shall have the right from time to time to demand and receive from one or more of the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within 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 due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Defaults and Remedies:

If any party fails to discharge any financial obligation under this agreement, including without limitation the failure to make any advance under the foregoing Article VII.B. or any preceding Article VII.A., or any provision of this agreement within the period required for such payment hereunder, then in addition to the remedies provided in Article VII.B. or elsewhere in this agreement, the remedies specified below shall be applicable. For purposes of this Article VII.D., all notices and elections shall be delivered
Article VII. EXPENDITURES AND LIABILITY OF PARTIES

B. LIENS AND SECURITY INTERESTS (continued)

agreement to cover debts "in any way connected with" and by so doing the indemnitee became liable for debts owing under the JOA.

Finally, the Form now includes expedited foreclosure provisions, which if followed carefully should simplify the foreclosure process.

C. ADVANCES

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 XVI. (See Article XVI.A. and Article XVI.B. for examples.)

The early drafts of the 1989 Form contained references to the creation of escrow accounts and separate segregated accounts. Language can be incorporated into Article VII or Article XVI to achieve this result.

Optional provision for escrow accounts:

At the election of Operator or of Non-Operators owning a majority interest in the costs of the proposed operation (after excluding the interest of Operator), Operator shall establish an escrow account in accordance with the provisions of Exhibit "H" attached hereto for collection and disbursement of funds advanced for such operation hereunder. Any such election must be made prior to the commencement of the operation for which such escrow is to be established. Such operation may include the Initial Well to be drilled pursuant to Article VI.A.

[See Article XVI.C. for a sample Escrow Agreement.]

Optional provision for separate accounts:

If an escrow account is not used, funds advanced hereunder shall upon request of a majority in interest of Non-Operators (after
B. Liens and Security Interests:

Each party grants to the other parties hereunto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest and/or purchase money security interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith, to secure performance of all of its obligations under this agreement including but not limited to payment of expense, interest and fees, the proper disbursement of all monies paid hereunder, the assignment or relinquishment of interest in Oil and Gas Leases as required hereunder, and the proper performance of operations hereunder. Such lien and security interest granted by each party hereto shall include such party's leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the Contract Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject to this agreement, the Oil and Gas when extracted therefrom and equipment situated thereon or used or obtained for use in connection therewith (including, without limitation, all tools, and tubular goods), and accounts (including, without limitation, accounts arising from gas imbalances or from the sale of Oil and/or Gas at the wellhead), contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of the foregoing.

To perfect the lien and security agreement provided herein, each party hereto shall execute and acknowledge the recording supplement and/or any financing statement prepared and submitted by any party hereto in conjunction herewith or at any time following execution hereof, and Operator is authorized to file this agreement or the recording supplement executed herewith as a lien or mortgage in the applicable real estate records and as a financing statement with the proper officer under the Uniform Commercial Code in the state in which the Contract Area is situated and such other states as Operator shall deem appropriate to perfect the security interest granted hereunder. Any party may file this agreement, the recording supplement executed herewith, or such other documents as it deems necessary as a lien or mortgage in the applicable real estate records and/or a financing statement with the proper officer under the Uniform Commercial Code.

Each party represents and warrants to the other parties hereto that the lien and security interest granted by such party to the other parties shall be a first and prior lien, and each party hereby agrees to maintain the priority of said lien and security interest against all persons acquiring an interest in Oil and Gas Leases and Interests covered by this agreement by, through or by the order of such party. All parties acquiring an interest in Oil and Gas Leases and Oil and Gas Interests covered by this agreement, whether by assignment, merger, mortgage, operation of law, or otherwise, shall be deemed to have subject to the lien and security interest granted by this Article VII.B. as to all obligations attributable to such interest hereunder whether or not such obligations arise before or after such interest is acquired.

To the extent that parties have a security interest under the Uniform Commercial Code of the state in which the Contract Area is situated, they 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 a party for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any party in the payment of its share of expenses, interest or fees, or upon the improper use of funds by the Operator, the other parties shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting party's share of Oil and Gas until the amount owed by such party, plus interest as provided in "Exhibit C," has been received, and shall have the right to offset the amount owed against the proceeds from the sale of such defaulting party's share of Oil and Gas. All purchasers of production may rely on a notification of default from the non-defaulting party or parties stating the amount due as a result of the default, and all parties waive any recourse available against purchasers for releasing production proceeds as provided in this paragraph.

If any party fails to pay its share of cost within one hundred twenty (120) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid by each party so paying its share of the unpaid amount shall be secured by the lien and security rights described in Article VII.B., and each paying party may independently pursue any remedy available hereunder or otherwise.

If any party does not perform all of its obligations hereunder, and the failure to perform subjects such party to foreclosure or execution proceedings pursuant to the provisions of this agreement, to the extent allowed by governing law, the defaulting party hereby waives any available right of redemption from and after the date of judgment, any required valuation or appraisement of the mortgaged or secured property prior to sale, any available right to stay execution or to require a marshaling of assets and any required bond in the event a receiver is appointed. In addition, to the extent permitted by applicable law, each party hereby grants to the other parties a power of sale as to any property that is subject to the lien and security rights granted hereunder, such power to be exercised in the manner provided by applicable law or otherwise in a commercially reasonable manner and upon reasonable notice.

Each party agrees that the other parties shall be entitled to utilize the provisions of Oil and Gas lien law or other lien law of any state in which the Contract Area is situated to enforce the obligations of each party hereunder. Without limiting the generality of the foregoing, to the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the mechanics' or materialmen's lien law of the state in which the Contract Area is situated in order to secure the payment to Operator of any sum due hereunder for services performed or materials supplied by Operator.

C. Advances:

Operator, at its election, shall have the right from time to time to demand and receive from one or more of the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within 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 due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Defaults and Remedies:

If any party fails to discharge any financial obligation under this agreement, including without limitation the failure to make any advance under the preceding Article VII.B., or any provision of this agreement, within the period required for such payment hereunder, then in addition to the remedies provided in Article VII.B. or elsewhere in this agreement, the remedies specified below shall be applicable. For purposes of this Article VII.D., all notices and elections shall be delivered
Article VII. EXPENDITURES AND LIABILITY OF PARTIES

C. ADVANCES (continued)

excluding the interest of Operator) be deposited in a separate interest-bearing account established by Operator at Operator's bank, in trust for the parties hereto, to be drawn on by Operator solely for the purpose of paying bills for the operations specified in the request for advance payments. Operator's possession of the funds advanced by all Non-Operators shall also be deemed possession by the Non-Operators for the purpose of perfecting the security interests of the Non-Operators therein. In the event of a change of Operator pursuant to the provisions hereof, any funds in such account not theretofore committed to any expenditures hereunder shall be returned to Non-Operators, and the new Operator shall establish a new trust account for the deposit of advances requested by such new Operator. In the event Operator becomes insolvent, bankrupt or subject to receivership, the funds in such account shall be immediately returned to Non-Operators.

The drafters at one point proposed that Operators also pay their proportionate share of expenses into the separate segregated account or provide a letter of credit. Although this concept can be of enormous benefit where, due to circumstances, the Operator is not financially secure, it should not be required of large financially secure companies as it will become a needless and expensive administrative burden. Understandably, many large Operators did not view the routine incorporation of this provision favorable. (And this is an understatement.) The drafters proposed the following language:

Operator shall pay its share of such advance at the time an advance from any Non-Operator is payable and shall deliver to such Non-Operator a bank statement or other satisfactory evidence confirming that such advance has been made. In lieu of such advance, Operator may obtain an irrevocable letter of credit satisfactory to Non-Operators to secure the payment of the Operator's share of the amounts advance.

Optional provision for letters of credit:

In lieu of requiring an advance from any Non-Operator, Operator may permit such Non-Operator to post an irrevocable letter of credit, in form and substance and issued by a financial institution satisfactory to
B. Liens and Security Interests:

Each party grants to the other parties hereunto a lien upon any interest it now owns or hereafter acquires in Oil and Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest and/or purchase money security interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained for use in connection therewith, to secure performance of all of its obligations under this agreement including but not limited to payment of expense, interest and fees, the proper disbursement of all monies paid hereunder, the assignment or relinquishment of interest in Oil and Gas Leases as required hereunder, and the proper performance of operations hereunder. Such lien and security interest granted by each party hereunto shall include such party's leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the Contract Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject to this agreement, the Oil and Gas when extracted therefrom and equipment situated thereon or used or obtained for use in connection therewith (including, without limitation, all wells, tools, and tubular goods), and accounts (including, without limitation, accounts arising from gas imbalances or from the sale of Oil and/or Gas at the wellhead), contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of the foregoing.

To perfect the lien and security agreement provided herein, each party hereto shall execute and acknowledge the recording supplement and/or any financing statement prepared and submitted by any party hereto in conjunction herewith or at any time following execution hereof, and Operator is authorized to file this agreement or the recording supplement executed herewith as a lien or mortgage in the applicable real estate records and as a financing statement with the proper officer under the Uniform Commercial Code in the state in which the Contract Area is situated and such other states as Operator shall deem appropriate to perfect the security interest granted hereunder. Any party may file this agreement, the recording supplement executed herewith, or such other documents as it deems necessary as a lien or mortgage in the applicable real estate records and/or a financing statement with the proper officer under the Uniform Commercial Code.

Each party represents and warrants to the other parties hereunto that the lien and security interest granted by such party to the other parties shall be a first and prior lien, and each party hereby agrees to maintain the priority of said lien and security interest against all persons acquiring an interest in Oil and Gas Leases and Interests covered by this agreement by, through or under such party. All parties acquiring an interest in Oil and Gas Leases and Oil and Gas Interests covered by this agreement, whether by assignment, merger, mortgage, operation of law, or otherwise, shall be deemed to have taken subject to the lien and security interest granted by this Article VII.B. as to all obligations attributable to such interest hereunder whether or not such obligations arise before or after such interest is acquired.

To the extent that parties have a security interest under the Uniform Commercial Code of the state in which the Contract Area is situated, they 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 a party for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In addition, upon default by any party in the payment of its share of expenses, interest or fees, or upon the improper use of funds by the Operator, the other parties shall have the right, without prejudice to other rights or remedies, to collect from the purchaser the proceeds from the sale of such defaulting party's share of Oil and Gas until the amount owed by such party, plus interest as provided in "Exhibit C," has been received, and shall have the right to offset the amount owed against the proceeds from the sale of such defaulting party's share of Oil and Gas. All purchasers of production may rely on a notification of default from the non-defaulting party or parties stating the amount due as a result of the default, and all parties waive any recourse available against purchasers for releasing production proceeds as provided in this paragraph.

If any party fails to pay its share of cost within one hundred twenty (120) days after rendition of a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid by each party so paying its share of the unpaid amount shall be secured by the lien and security rights described in Article VII.B., and each paying party may independently pursue any remedy available hereunder or otherwise.

If any party does not perform all of its obligations hereunder, and the failure to perform subjects such party to foreclosure or execution proceedings pursuant to the provisions of this agreement, to the extent allowed by governing law, the defaulting party hereby waives any available right of redemption from and after the date of judgment, any required valuation or appraisal of the mortgaged or secured property prior to sale, any available right to stay execution or to require a marshalling of assets and any required bond in the event a receiver is appointed. In addition, to the extent permitted by applicable law, each party hereby grants to the other parties a power of sale as to any property that is subject to the lien and security rights granted hereunder, such power to be exercised in the manner provided by applicable law or otherwise in a commercially reasonable manner and upon reasonable notice.

Each party agrees that the other parties shall be entitled to utilize the provisions of Oil and Gas law or other lien law of any state in which the Contract Area is situated to enforce the obligations of each party hereunder. Without limiting the generality of the foregoing, to the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the mechanics' or materialmen's lien law of the state in which the Contract Area is situated in order to secure the payment to Operator of any sum due hereunder for services performed or materials supplied by Operator.

C. Advances:

Operator, at its election, shall have the right from time to time to demand and receive from one or more of the other parties payment in advance of their respective shares of the estimated amount of the expense to be incurred in operations hereunder during the next succeeding month, which right may be exercised only by submission to each such party of an itemized statement of such estimated expense, together with an invoice for its share thereof. Each such statement and invoice for the payment in advance of estimated expense shall be submitted on or before the 20th day of the next preceding month. Each party shall pay to Operator its proportionate share of such estimate within 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 due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be made monthly between advances and actual expense to the end that each party shall bear and pay its proportionate share of actual expenses incurred, and no more.

D. Defaults and Remedies:

If any party fails to discharge any financial obligation under this agreement, including without limitation the failure to make any advance under the preceding Article VII.C. or any other provision of this agreement, within the period required for such payment hereunder, then in addition to the remedies provided in Article VII.B. or elsewhere in this agreement, the remedies specified below shall be applicable. For purposes of this Article VII.D., all notices and elections shall be delivered
Article VII. EXPENDITURES AND LIABILITY OF PARTIES

C. ADVANCES (continued)

Operator, to secure the amount of such advance. Operator shall assume the sole cost and risk of collecting under any such letter of credit.

Due to the complaints of many oil and gas companies who objected to the inclusion of escrow accounts and separate segregated accounts, the drafters decided against the inclusion of these provisions. Those that objected to the inclusion, argued that it was overkill to require the Operator to routinely establish escrow accounts and separate segregated accounts, when problems were likely to occur in only a small percentage of the JOAs. Where such problems might be anticipated, appropriate measures, such as escrow accounts and separate segregated accounts, should be employed.

D. DEFAULTS AND REMEDIES

The rights of a party who is in default under the JOA, are suspended. An Operator who is in default can be replaced by a vote of the Non-Operators owning a majority interest. A defaulting party is denied, among others, the following rights: to receive operational information; to elect to participate in an operation, whether or not the defaulting party has previously elected to participate; and the right to receive proceeds from the sale of production. Non-defaulting parties can sue (at joint account expense) to recover money owed, interest, consequential damages, attorneys' fees and costs.

By deeming a defaulting party to have elected not to participate (go non-consent) in a well and by denying such party production from the Contract Area, the JOA effectively causes the defaulting party to forfeit its economic interest without explicitly calling for a forfeiture. By so doing, the 1989 Form likely achieves the result of removing the defaulting party without running afoul of the general rule that courts do not favor forfeiture and forfeit clauses are strictly construed. Deemed non-consent provisions are more likely to be found acceptable, and not unenforceable forfeitures if they apply when material or significant defaults occur, such as the failure to pay expenses when due; restrict the interest temporarily relinquished to the Contract Area; and do not use terms like "forfeiture" or "liquidated damages." Conine, Rights and Liabilities of Carried Interest and Nonconsent Parties in Oil and Gas Operations, 37th Oil & Gas Inst. (Matthew Bender 1986), at 3-1.
only by Operator, except that Operator shall deliver any such notice and election requested by a non-defaulting Non-Operator, and when Operator is the party in default, the applicable notices and elections can be delivered by any Non-Operator. Election of any one or more of the following remedies shall not preclude the subsequent use of any other remedy specified below or otherwise available to a non-defaulting party.

1. Suspension of Rights. Any party may deliver to the party in default a Notice of Default, which shall specify the default, specify the action to be taken to cure the default, and specify that failure to take such action will result in the exercise of one or more of the remedies provided in this Article. If the default is not cured within thirty (30) days of the delivery of such Notice of Default, all of the rights of the defaulting party granted by this agreement may upon notice be suspended until the default is cured, without prejudice to the right of the non-defaulting party or parties to continue to enforce the obligations of the defaulting party previously accrued under this agreement. If Operator is the party in default, the Non-Operators shall have in addition the right, by vote of Non-Operators owning a majority in interest in the Contract Area after excluding the voting interest of Operator, to appoint a new Operator effective immediately. The rights of a defaulting party that may be suspended hereunder at the election of the non-defaulting parties shall include, without limitation, the right to receive information as to any operation conducted hereunder during the period of such default, the right to elect to participate in an operation proposed under Article VI.B. of this agreement, the right to participate in an operation being conducted under this agreement even if the party has previously elected to participate in such operation, and the right to receive proceeds of production from any well subject to this agreement.

2. Suit for Damages. Non-defaulting parties or Operator for the benefit of non-defaulting parties may sue (as joint account expense) to collect the amounts in default, plus interest accruing on the amounts recovered from the date of default until the date of collection at the rate specified in Exhibit "C" attached hereto. Nothing herein shall prevent any party from suing any defaulting party to collect consequential damages accruing to such party as a result of the default.

3. Deemed Non-Consent. The non-defaulting party may deliver a written Notice of Non-Consent Election to the defaulting party at any time after the expiration of the thirty-day cure period following delivery of the Notice of Default, in which event if the billing is for the drilling of a new well or the Plugging Back, Sidetracking, Reworking or Deepening of a well which is to be or has been plugged as a dry hole, or for the Completion or Recompletion of any well, the defaulting party will be conclusively deemed to have elected not to participate in the operation and to become a Non-Consenting Party with respect thereto under Article VI.B. or VI.C., as the case may be, to the extent of the costs unpaid by such party, notwithstanding any election to participate theretofore made. If election is made to proceed under this provision, then the non-defaulting parties may not elect to sue for the unpaid amount pursuant to Article VII.D.2.

Until the delivery of such Notice of Non-Consent Election to the defaulting party, such party shall have the right to cure its default by paying its unpaid share of costs plus interest at the rate set forth in Exhibit "C," provided, however, such payment shall not prejudice the rights of the non-defaulting parties to pursue remedies for damages incurred by the non-defaulting parties as a result of the default. Any interest relinquished pursuant to this Article VII.D.3. shall be offered to the non-defaulting parties in proportion to their interests, and the non-defaulting parties electing to participate in the ownership of such interest shall be required to contribute their shares of the defaulted amount upon their election to participate therein.

Advance Payment. If a default is not cured within thirty (30) days of the delivery of a Notice of Default, Operator, or Non-Operators if Operator is the defaulting party, may thereafter require advance payment from the defaulting party of such defaulting party's anticipated share of any item of expense for which Operator, or Non-Operators, as the case may be, would be entitled to reimbursement under any provision of this agreement, whether or not such expense was the subject of the previous default. Such right includes, but is not limited to, the right to require advance payment for the estimated costs of drilling a well or Completion of a well as to which an election to participate in drilling or Completion has been made. If the defaulting party fails to pay the required advance payment, the non-defaulting parties may pursue any of the remedies provided in this Article VII.D. or any other default remedy provided elsewhere in this agreement. Any excess of funds advanced remaining when the operation is completed and all costs have been paid shall be promptly returned to the advancing party.

5. Costs and Attorneys' Fees. In the event any party is required to bring legal proceedings to enforce any financial obligation of a party hereunder, the prevailing party in such action shall be entitled to recover all court costs, costs of collection, and a reasonable attorney's fee, which the lien provided for herein shall also secure.


Rentals, shut-in well payments and minimum royalties which may be required under the terms of any lease shall be paid by the party or parties who subject such lease to this agreement at its or their expense. In the event two or more parties own and have contributed interests in the same lease to this agreement, such parties may designate one of such parties to make said payments for and on 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 failure to make proper payment of any rental, shut-in well payment or minimum royalty through mistake or oversight where such payment is required to continue the lease in force, any loss which results from such non-payment shall be borne in accordance with the provisions of Article IV.B.2.

Operator shall notify Non-Operators of the anticipated completion of a shut-in well, or the shutting in or return to production of a producing well, at least five (5) days in advance of such event, or at the earliest opportunity permitted by circumstances, but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-Operators, the loss of any lease contributed hereto by Non-Operators for failure to make timely payments of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article IV.B.3.

F. Taxes:

Beginning with the first calendar year after the effective date hereof, Operator shall render for ad valorem taxation all property subject to this agreement which by law should be rendered for such taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to that date, Operator shall furnish Operator information as to burdens (to include, but not be limited to, royalties, overriding royalties and production payments) on Leases and Oil and Gas Interests contributed by such Non-Operator. If the assessed valuation of any Lease is reduced by reason of it being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such Lease, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such reduction. 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 for party's working interest. Operator shall bill the other parties for their proportionate shares of all tax payments in the manner provided in Exhibit "C."
Article VII. EXPENDITURES AND LIABILITY OF PARTIES

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.

F. TAXES

While the Operator will pay all ad valorem taxes, each party is to pay its production, severance, excise gathering and other taxes.
ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

ARTICLE VIII.

A. Surrender of Leases:

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

However, should any party desire to surrender its interest in any Lease or in any portion thereof, such party shall give written notice of the proposed surrender to all parties, and the parties to whom such notice is delivered shall have thirty (30) days after delivery of the notice within which to notify the party proposing the surrender whether they elect to consent thereto. Failure of a party to whom such notice is delivered to reply within said 30-day period shall constitute a consent to the surrender of the Leases described in the notice. If all parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such Lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not consenting to such surrender. If the interest of the assigning party is or includes an Oil and Gas Interest, the assigning party shall execute and deliver to the party or parties not consenting to such surrender an oil and gas lease covering 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 lease to be on the form attached hereto as Exhibit "B."

Upon such assignment or lease, the assigning party shall be relieved from all obligations thereafter accruing, but not theretofore accrued, with respect to the interest assigned or leased and the operation of any well attributable thereto, and the assigning party shall have no further interest in the assigned or leased acreage or its equipment and production other than the royalties retained in any lease made under the terms of this Article. The assignee or lessee shall pay to the party assignor or lessor the reasonable salvage value of the latter's interest in any well's salvable materials and equipment attributable to the assigned or leased acreage. The value of all salvable materials and equipment shall be determined in accordance with the provisions of Exhibit "C."

The estimated cost of salvaging and the estimated cost of plugging and abandoning and restoring the surface. If such value is less than such costs, then the party assignor or lessee shall pay to the party assignee or lessee the amount of such deficit. If the assignment or lease is in favor of more than one party, the interest shall be shared by such parties in the proportions that the interest of each bears to the total interest of all such parties. If the interest of the parties to whom the assignment is to be made varies according to depth, then the interest assigned shall similarly reflect such variances. Any assignment, lease or surrender made under this provision shall not reduce or change the assignor's, lessor's or surrendering party's interest as it was immediately before the assignment, lease or surrender in the balance of the Contract Area; and the acreage assigned, leased or surrendered, and subsequent operations thereon, shall not thereafter be subject to the terms and provisions of this agreement but shall be deemed subject to an Operating Agreement in the form of this agreement.

B. Renewal or Extension of Leases:

If any party secures a renewal or replacement of an Oil and Gas Lease or Interest subject to this agreement, then all other parties shall be notified promptly upon such acquisition or, in the case of a replacement Lease taken before expiration of an existing Lease, promptly upon expiration of the existing Lease. The parties notified shall have the right for a period of thirty (30) days following delivery of such notice in which to elect to participate in the ownership of the renewal or replacement Lease, insofar as such Lease affects lands within the Contract Area, by paying to the party who acquired it their proportionate shares of the acquisition cost allocated to that part of such Lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area. Each party who participates in the purchase of a renewal or replacement Lease shall be given an assignment of its proportionate interest therein by the acquiring party.

If some, but less than all, of the parties elect to participate in the purchase of a renewal or replacement Lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal or replacement Lease. The acquisition of a renewal or replacement Lease by any or all of the parties hereto shall not cause a readjustment of the interests of the parties stated in Exhibit "A," but any renewal or replacement Lease in which less than all parties elect to participate shall not be subject to this agreement but shall be deemed subject to a separate Operating Agreement in the form of this agreement.

If the interests of the parties in the Contract Area vary according to depth, then their right to participate proportionately in renewal or replacement Leases and their right to receive an assignment of interest shall also reflect such depth variances. The provisions of this Article shall apply to renewal or replacement Leases whether they are for the entire interest covered by the expiring Lease or cover only a portion of its area or an interest therein. Any renewal or replacement Lease taken before the expiration of its predecessor Lease, or taken or contracted for or becoming effective within six (6) months after the expiration of the existing Lease, shall be subject to this provision so long as this agreement is in effect at the time of such acquisition or at the time the renewal or replacement Lease becomes effective; but any Lease taken or contracted for more than six (6) months after the expiration of an existing Lease shall not be deemed a renewal or replacement Lease and shall not be subject to the provisions of this agreement.

The provisions in this Article shall also be applicable to extensions of Oil and Gas Leases.

C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash towards the drilling of a well or, any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party for whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. Such acreage shall become a separate Contract Area and, to the extent possible, be governed by provisions identical to this agreement. Each party shall promptly notify all other parties of any acreage or cash contributions it may obtain in support of any well or any other operation on the Contract Area. The above provisions shall also be applicable to optional rights to earn acreage outside the Contract Area which are in support of well drilled inside the Contract Area.
Article VIII. ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

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 party's 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 party's interest should not be reduced in the Contract Area. To understand this distinction, it must be remembered that the parties to a JOA have "contractually 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 wishes to acquire the surrendered acreage, they can do so and such acreage would not be governed by the JOA.

The party or parties assuming the interest, shall pay the surrendering party the reasonable salvage value of all related material and equipment, less the estimated cost of salvaging, plugging and abandonment and surface restoration. The drafters of the 1989 Form, recognized that the cost of salvaging, plugging and abandonment and surface restoration could exceed the value of the lease and in these circumstances the surrendering party shall pay such deficit to those partners who assume its interest. Surrendered interests are now explicitly governed by the JOA in the form of the underlying agreement.

B. RENEWAL OR EXTENSION OF LEASES

This Form now addresses renewals, replacements and extensions of leases. This clarifies an ambiguity in the 1982 Form and is a clear improvement. Although top leases are not specifically referred to they should be included within the scope of a renewal, replacement or extension of an Oil and Gas Lease.

Any lease which is renewed or replaced 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 interest in the Contract Area. Renewal or replacement is defined as a lease that is taken within six months after the expiration of the existing lease. If some, but not all of 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
ARTICLE VIII.

ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

1. A. Surrender of Leases:

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

However, should any party desire to surrender its interest in any Lease or in any portion thereof, such party shall give written notice of the proposed surrender to all parties, and the parties to whom such notice is delivered shall have thirty (30) days after delivery of the notice within which to notify the party proposing the surrender whether they elect to consent thereto. Failure of a party to whom such notice is delivered to reply within said 30-day period shall constitute a consent to the surrender of the Leases described in the notice. If all parties do not agree or consent thereto, the party desiring to surrender shall assign, without express or implied warranty of title, all of its interest in such Lease, or portion thereof, and any well, material and equipment which may be located thereon and any rights in production thereafter secured, to the parties not consenting to such surrender. If the interest of the assigning party is or includes an Oil and Gas Interest, the assigning party shall execute and deliver to the party or parties not consenting to such surrender an oil and gas lease covering 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 lease to be on the form attached hereto as Exhibit "B."

Upon such assignment or lease, the assigning party shall be relieved from all obligations thereunder accruing, but not theretofore accrued, with respect to the interest assigned or leased and the operation of any well attributable thereto, and the assigning party shall have no further interest in the assigned or leased interest, its equipment and production other than the royalties retained in any lease made under the terms of this Article. The assignee or lessee shall pay to the party assignor or lessor the reasonable salvage value of the latter's interest in any well's salvable materials and equipment attributable to the assigned or leased acreage. The value of all salvable materials and equipment shall be determined in accordance with the provisions of Exhibit "C."

2. B. Renewal or Extension of Leases:

If any party secures a renewal or replacement of an Oil and Gas Lease or Interest subject to this agreement, then all other parties shall be notified promptly upon such acquisition or, in the case of a replacement Lease taken before expiration of an existing Lease, promptly upon expiration of the existing Lease. The parties notified shall have the right for a period of thirty (30) days following delivery of such notice in which to elect to participate in the ownership of the renewal or replacement Lease, insofar as such Lease affects lands within the Contract Area, by paying to the party who acquired it their proportionate shares of the acquisition cost allocated to that part of such Lease within the Contract Area, which shall be in proportion to the interests held at that time by the parties in the Contract Area. Each party who participates in the purchase of a renewal or replacement Lease shall be given an assignment of its proportionate interest therein by the acquiring party.

If some, but not less than all, of the parties elect to participate in the purchase of a renewal or replacement Lease, it shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of their respective percentage of participation in the Contract Area to the aggregate of the percentages of participation in the Contract Area of all parties participating in the purchase of such renewal or replacement Lease. The acquisition of a renewal or replacement Lease by any or all of the parties hereto shall not cause a readjustment of the interests of the parties stated in Exhibit "A."

3. C. Acreage or Cash Contributions:

While this agreement is in force, if any party contracts for a contribution of cash towards the drilling of a well or, any other operation on the Contract Area, such contribution shall be paid to the party who conducted the drilling or other operation and shall be applied by it against the cost of such drilling or other operation. If the contribution be in the form of acreage, the party for whom the contribution is made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling Parties in the proportions said Drilling Parties shared the cost of drilling the well. Such acreage shall become a separate Contract Area and, to the extent possible, be governed by provisions identical to this agreement. Each party shall promptly notify all other parties of any acreage or cash contributions it may obtain in support of any well or any other operation on the Contract Area. The above provisions shall also be applicable to optional rights to earn acreage outside the Contract Area which are in support of well drilled inside the Contract Area.
Article VIII. ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

B. RENEWAL OR EXTENSION OF LEASES (continued)

Contract Area. In this event, the lease renewal or replacement shall now be governed by a JOA in the form of the underlying agreement.

The third paragraph of this provision states in its entirety "[I]f the interests of the parties in the Contract Area vary according to depth, then their right to participate proportionally in renewal or replacement Leases and their right to receive an assignment of interest shall also reflect such depth variances." How will the individual allocations be valued in situations where the interests of the parties vary according to depth? Alternatively, if there is no individual allocation, would a party who contributed two leases, which have depth limitations of 10,000 feet and 12,000 feet, average the two leases and pay its proportionate share for an 11,000 foot assignment?

C. ACREAGE OR CASH CONTRIBUTIONS

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. See Superior Oil Co. v. Cox, 307 So.2d 350 (La. 1975). In addition, in Harper Oil Co. v. Yates Petroleum Corp., 733 P.2d 1313 (N.M. 1987), the Supreme Court of New Mexico ruled that when read together Article VI. and Article VIII.C. were ambiguous. The court did, however, reach the correct conclusion in not requiring Yates to share a farmout it acquired from a party to the JOA with Harper who was also a party to the JOA. The 1989 Form adds a final sentence which provides that any party can dispose of its share of production without falling within the purview of Article VII.C.

The 1989 Form explicitly states that no assignment or other disposition shall relieve a party of any obligations previously incurred, including the obligation to pay all costs attributable to its interest and the lien and security interest. In this regard, reference should be made to Article VII.B., lines 7 to 14. Note the reference to accounts arising from gas imbalances. A simple assignment does not extinguish the assignor's liability for a gas overlift imbalance. Only a novation will accomplish this result. In accordance with this provision, every sale, encumbrance or transfer is
If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Assignment; Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership of the Contract Area in the Oil and Gas Leases, Oil and Gas Interests, wells, equipment, and production covered by this agreement no party shall sell, encumber, transfer or make other disposition of its interest in the Oil and Gas Leases and Oil and Gas Interests embraced within the Contract Area or in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production; or
2. an equal undivided percent of the party's present interest in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production in the Contract Area.

Every sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement and shall be made without prejudice to the right of the other parties, and any transferee of an ownership interest in any Oil and Gas Lease or Interest shall be deemed a party to this agreement as to the interest conveyed from and after the effective date of the transfer of ownership; provided, however, that the other parties shall not be required to recognize any such sale, encumbrance, transfer or other disposition for any purpose hereunder until thirty (30) days after they have received a copy of the instrument of transfer or other satisfactory evidence thereof in writing from the transferor or transferee. No assignment or other disposition of interest by a party shall relieve such party of obligations previously incurred by such party hereunder with respect to the interest transferred, including without limitation the obligation of a party to pay all costs attributable to an operation conducted hereunder in which such party has agreed to participate prior to making such assignment, and the lien and security interest granted by Article VII.B. shall continue to burden the interest transferred to secure payment of any such obligations.

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 require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for 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 party's interest within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the Oil and Gas produced from the Contract Area and they shall have the right to receive, separately, payment of the proceeds thereof.

E. Waiver of Rights to Partition:

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

F. Preferential Right to Purchase:

(Indent; Check if applicable.) Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall have an optional right prior right, for a period of ten (10) days after the notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to transfer title to its interests to its mortgagee in lieu of or pursuant to foreclosure of a mortgage of its interests, or to dispose of its interests by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets to any party, or by transfer of its interests to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which such party owns a majority of the stock.

ARTICLE IX.

INTERNAL REVENUE CODE ELECTION

If, for federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, and if the parties have not otherwise agreed to form a tax partnership pursuant to Exhibit "G" or other agreement between them, each party thereby affected elects to be excluded from the application of all of the provisions of Subchapter "K," Chapter 1, Subtitle "A," of the Internal Revenue Code of 1986, as amended ("Code"), as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Treasury Regulations §1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K," Chapter 1, Subtitle "A," of the Code, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from operations hereunder can be adequately determined without the computation of partnership taxable income.

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 ____ Dollars ($____ _) 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 VIII. ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

C. ACREAGE OR CASH CONTRIBUTIONS (continued)

"made subject" to the JOA and any transferee shall be deemed a party to the JOA. Does this provision bind a bona fide good faith purchaser who is unaware of the existence of the JOA? Probably not, unless it could be proven that the bona fide good faith purchaser should have known of the existence of the JOA. The parties to the JOA need not recognize any such sale, encumbrance or transfer until 30 days after they have received a copy of the transfer instrument.

D. ASSIGNMENT; MAINTENANCE OF 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. The new assignment provision makes clear the transfer of ownership and, with regard to the parties to the JOA, is not recognized until 30 days after satisfactory notice has been received. In addition, the transferor is liable for all costs incurred prior to making such assignment. In light of environmental concerns and the fact that the preferential right to transfer is frequently deleted, it might be advisable to restrict transfers to financially responsible parties (or those that can provide good security) and require appropriate indemnities. Remember, however, that such a restriction will affect you if and when you choose to transfer your interest.

The drafters chose not to amend the Uniform Maintenance of Interest provision. This provision is universally ignored. There are no clear damages that flow from its violation. Conceptually, the remedy for breach would be for specific performance and damages, if any could be proven. And with the advent of computers, the administration of small interests is being made increasingly easy. Parties should consider deleting the first paragraph of this Article.

The requirement that transfers must cover a party's "entire interest" or "an equal undivided percent of the party's present interest" is not as clear as it may first appear. A party owning an undivided one-quarter interest in one lease and an undivided one-half interest in a second lease would technically comply with the second requirement of Article VIII.D. if he transferred an undivided one-quarter interest in both leases to a party; but obviously, the ownership interest will no longer be uniform. It has been argued that the maintenance of uniform interest provision is invalid because it is a restraint on alienation. Rooker, Acquiring Interest in an Area Covered by a Joint Operating Agreement, LANDMAN, July/Aug., 1988.
A.A.P.L. FORM 610 - MODEL FORM OPERATING AGREEMENT - 1989

D. Assignment; Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the Contract Area in the Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production covered by this agreement no party shall sell, encumber, transfer or make other disposition of its interest in the Oil and Gas Leases and Oil and Gas Interests embraced within the Contract Area or in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production; or

2. an equal undivided percent of the party's present interest in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production in the Contract Area.

Every sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement and shall be made without prejudice to the right of the other parties, and any transferee of an ownership interest in any Oil and Gas Lease or Interest shall be deemed a party to this agreement as to the interest conveyed from and after the effective date of the transfer of ownership; provided, however, that the other parties shall not be required to recognize any such sale, encumbrance, transfer or other disposition for any purpose hereunder until thirty (30) days after they have received a copy of the instrument of transfer or other satisfactory evidence thereof in writing from the transferor or transferee. No assignment or other disposition of interest by a party shall relieve such party of obligations previously incurred by such party hereunder with respect to the interest transferred, including without limitation the obligation of a party to pay all costs attributable to an operation conducted hereunder in which such party has agreed to participate prior to making such assignment, and the lien and security interest granted by Article VII.B. shall continue to burden the interest transferred to secure payment of any such obligations.

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 require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for 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 party's interest within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the Oil and Gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds thereof.

E. Waiver of Rights to Partition:

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

F. Preferential Right to Purchase:

(Official; Check if applicable.) Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall then have an option prior right, for a period of ten (10) days after the notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell; and, if this option right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to transfer title to its interests to its mortgagee in lieu of or pursuant to foreclosure of a mortgage of its interests, or to dispose of its interests by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets to any party, or by transfer of its interests to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which such party owns a majority of the stock.

ARTICLE IX.

INTERNAL REVENUE CODE ELECTION

If, for federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, and if the parties have not otherwise agreed to form a tax partnership pursuant to Exhibit "G" or other agreement between them, each party thereby affected to elect to be excluded from the application of all of the provisions of Subchapter "K," Chapter 1, Subtitle "A," of the Internal Revenue Code of 1986, as amended ("Code"), as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Treasury Regulations §1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K," Chapter 1, Subtitle "A," of the Code, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from operations hereunder can be adequately determined without the computation of partnership taxable income.

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 ** Dollars ($________) 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 share in proportion to the amount of their respective interests the joint and several liability with respect to such claim or suit. The other parties shall have immediately after receipt of notice from Operator of the settlement in such an uninsured third party damage claim or suit, the right to participate in the defense thereof, and if at any time the liability of the Operator hereunder is in excess of the amount reserved by the Operator and the other parties shall contribute to such excess in proportion to their respective interests. 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. See IV.B.
Article VIII. ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

D. ASSIGNMENT; MAINTENANCE OF UNIFORM INTEREST (continued)

The maintenance of uniform interest provision protects the parties by prohibiting wellbore assignments and assignments of one or more Drilling Units which encompass less than the whole of the Contract Area. See Article IV.B.1.(g). Before a party can sell a portion of the Contract Area or a wellbore, the parties must agree to amend the JOA and revise the Contract Area and Exhibit "A." A new JOA should be entered into covering the area assigned. If this is not properly handled the assignee may be able to claim an interest in acreage within the Contract Area of the original JOA, but outside the property assigned. Problems can arise in the following scenario:

1. Exxon and Shell sign a JOA covering a 640 acre section. The Exhibit "A" gives each company a 50% interest.

2. Exxon owns the west half and Shell owns the east half.

3. One well has been drilled. The well is marginally successful, producing 40 barrels a day and is located on the northwest quarter on a 160 acre Drilling Unit.

4. Exxon, without amending the maintenance of uniform interest provision, assigns its 50% interest in the northwest quarter to ARCO.

5. On the same day of the assignment, a prolific well is completed on the southwest quarter (160 acre Drilling Unit) which produces 5000 barrels per day.

What does ARCO own? Does ARCO own 50% of the 40 barrel a day well on the northwest quarter? Does ARCO own 12.50% of the Contract Area and 12.50% of the production from the 40 barrel a day well on the northwest quarter and 12.50% of the production from the 5000 barrel a day well on the southwest quarter? Does ARCO own nothing because Exxon violated the maintenance of uniform interest provision? Notwithstanding the technical violation of the maintenance of uniform interest provision, ARCO should be entitled to only a 50% interest in the northwest quarter and it should have no interest in the Contract Area outside of the northwest quarter. This assumes that a court would not grant an extraordinary remedy to enjoin or reverse the sale. Life could get messy if ARCO ratified the JOA and argued that by acquiring a 50% interest in the northwest quarter, it became a party to the JOA and acquired a 12.50% interest in the Contract Area.
If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Assignment; Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the Contract Area in the Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production covered by this agreement no party shall sell, encumber, transfer or make other disposition of its interest in the Oil and Gas Leases and Oil and Gas Interests embraced within the Contract Area or in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production; or
2. an equal undivided percent of the party's present interest in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production in the Contract Area.

Every sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement and shall be made without prejudice to the right of the other parties, and any transferee of an ownership interest in any Oil and Gas Lease or Interest shall be deemed a party to this agreement as to the interest conveyed from and after the effective date of the transfer of ownership; provided, however, that the other parties shall not be required to recognize any such sale, encumbrance, transfer or other disposition for any purpose hereunder until thirty (30) days after they have received a copy of the instrument of transfer or other satisfactory evidence thereof in writing from the transferor or transferee. No assignment or other disposition of interest by a party shall relieve such party of obligations previously incurred by such party hereunder with respect to the interest transferred, including without limitation the obligation of a party to pay all costs attributable to an operation conducted hereunder in which such party has agreed to participate prior to making such assignment, and the lien and security interest granted by Article VII.B. shall continue to burden the interest transferred to secure payment of any such obligations.

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 require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for 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 party's interest within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the Oil and Gas produced from the Contract Area and they shall have the right to receive, separately, payment of the proceeds thereof.

E. Waiver of Rights to Partition:

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

F. Preferential Right to Purchase:

(Optional; Check if applicable.)

Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after the notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasers. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to transfer title to its interests to its mortgagee in lieu of or pursuant to foreclosure of a mortgage of its interests, or to dispose of its interests by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets to any party, or by transfer of its interests to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which such party owns a majority of the stock.

ARTICLE IX.

INTERNAL REVENUE CODE ELECTION

If, for federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, and if the parties have not otherwise agreed to form a tax partnership pursuant to Exhibit "G" or other agreement between them, each party thereby affected elects to be excluded from the application of all of the provisions of Subchapter "K," Chapter 1, Subtitle "A," of the Internal Revenue Code of 1986, as amended ("Code"), as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Treasury Regulations §1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K," Chapter 1, Subtitle "A," of the Code, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from operations hereunder can be adequately determined without the computation of partnership taxable income.

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 __________ Dollars ($________) 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.

See IV.B.
Article VIII. ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

E. WAIVER OF RIGHTS TO PARTITION

Some states sanction a party's desire to force a partition of an undivided interest. Article VIII.E. waives a party's right where applicable to seek partition.

F. PREFERENTIAL RIGHT TO PURCHASE

The preferential right to purchase clause is now an optional provision. The drafters have refused to address the age old question of whether the word "sell" includes "farmout." I believe it does. Prior drafts stated that should "any party desire to sell or farmout or make other similar disposition" it shall give notice to the other parties. For the sake of clarity, this portion of the Form should be amended accordingly. See Panuco Oil Leases, Inc. v. Conroe Drilling Co., 202 F. Supp 108 (S.D. Tex. 1961). The 1989 Form incorporates four seemingly innocuous revisions to this provision. First, the provision is made optional and the parties are to check a box if the provision is to apply.

Second, the notice of preferential rights must now include a "legal description of the property sufficient to identify the property."

Third, the prior reference to a "proposed sale" has been changed to a "proposed disposition" and the "prospective purchaser" is now referred to as the "prospective transferee". Why did the drafters revise this language? It could be argued that these revisions expand the applicability of the provision to transactions other than sales, including farmouts and exchanges. This argument is severely undercut by the fact that the first line of the provision explicitly and exclusively references only a party's desire to "sell." In prior drafts of the Form, this provision referenced both sales and farmouts. The reference to farmouts was deleted in the final version. Perhaps, the drafters failed when they deleted the reference to farmouts to concomitantly revise this related language.

Fourth and finally, transfers by a party in lieu of foreclosure and sales of substantially all of a party's Oil and Gas are now excluded from the application of this provision.

Al Minter and Ann Girardeau Wacker in a comprehensive article on preferential rights and the JOA contend that exchanges, farmouts and package sales all should be considered "sales" which trigger the operation of the preferential purchase provision. Minter and Girardeau, The Rights and Obligations of Parties to Joint Operating Agreements Under Preferential Rights Provisions, LANDMAN, Mar./Apr., 1990.
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If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Assignment; Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the Contract Area in the Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production covered by this agreement no party shall sell, encumber, transfer or make other disposition of its interest in the Oil and Gas Leases and Oil and Gas Interests embraced within the Contract Area or in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production; or
2. an equal undivided percent of the party's present interest in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production in the Contract Area.

Every sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement and shall be made without prejudice to the right of the other parties, and any transferee of an ownership interest in any Oil and Gas Lease or Interest shall be deemed a party to this agreement as to the interest conveyed from and after the effective date of the transfer of ownership, provided, however, that the other parties shall not be required to recognize any such sale, encumbrance, transfer or other disposition for any purpose hereunder until thirty (30) days after they have received a copy of the instrument of transfer or other satisfactory evidence thereof in writing from the transferor or transferee. No assignment or other disposition of interest by a party shall relieve such party of obligations previously incurred by such party hereunder with respect to the interest transferred, including without limitation the obligation of a party to pay all costs attributable to an operation conducted hereunder in which such party has agreed to participate prior to making such assignment, and the lien and security interest granted by Article VII.B. shall continue to burden the interest transferred to secure payment of any such obligations.

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 require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for 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 party's interest within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the Oil and Gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds thereof.

E. Waiver of Rights to Partition:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an 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 interest therein.

F. Preferential Right to Purchase:

(Optional; Check if applicable.) Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after the notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to transfer title to its interests to its mortgagee in lieu of or pursuant to foreclosure of a mortgage of its interests, or to dispose of its interests by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets to any party, or by transfer of its interests to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which such party owns a majority of the stock.

ARTICLE IX.
INTERNAL REVENUE CODE ELECTION

If, for federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, and if the parties have not otherwise agreed to form a tax partnership pursuant to Exhibit "G" or other agreement between them, each party thereby affected elects to be excluded from the application of all of the provisions of Subchapter "K," Chapter 1, Subtitle "A," of the Internal Revenue Code of 1986, as amended ("Code"), as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Treasury Regulations §1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K," Chapter 1, Subtitle "A," of the Code, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party states that the income derived by such party from operations hereunder can be adequately determined without the computation of partnership taxable income.

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 ____________________ Dollars ($____________) 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.

See IV.B.
Article VIII. ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

F. PREFERENTIAL RIGHT TO PURCHASE (continued)

However, in the event a transaction involves an exchange of properties, barring bad faith or unreasonableness on the part of the seller, unless the holder of the preferential right can acquire the property desired by the owner as consideration for parting with title to the property burdened by the right, the holder shall not be permitted to prevent the exchange. The same result, it is argued, applies where the exchanged consideration is a unique chattel (personal property) other than cash. In light of the fact that all oil and gas properties can be valued in monetary terms, is this analysis correct? Perhaps, the dispute should center around the associated value not the specific exchanged property contemplated. This analysis is complicated by the tax implications involved in exchanged property, where such exchanges may be accomplished on a tax free basis.

Although preferential purchase provisions may appear to extend beyond 21 years they do not violate the rule against perpetuities as they are not an interest in real property, but rather only a contract right. Producers Oil Co. v. Gore, 610 P.2d 772 (Okla. 1980).

Under the Minter and Wacker analysis, farmouts are equated with exchanges, although the authors admit to a dearth of judicial support. Why should a holder of a preferential right not be able to farm in to an interest owned within the Contract Area? How does a farmout conceptually differ from a sale where the transfer or reserves on override and/or a reversionary interest?

Finally, Minter and Decker contend that package sales come within the purview of the preferential purchase right and holders have the right to enjoin the closing of a transaction until they are given the right to purchase the individual property. Allocations can be extremely difficult to calculate and undoubtedly will be contentious. For this reason, it is recommended that specific language be incorporated which addresses package sales.

The provision does not address large package sales which although, are not "substantially all of its Oil and Gas assets," are nevertheless significant. In light of the sale of large packages of Oil and Gas properties and the concomitant disputes that have arisen, it may be worthwhile to examine whether an exception should also be made for significant package sales. Consideration should be given to the incorporation of a provision which would exclude a sale of an interest if the interest sold represents less than ______ % of a package or group of interests being sold.

George Kutzschbach, in a comprehensive and excellent analysis of preferential rights
If any party contracts for any consideration relating to disposition of such party's share of substances produced hereunder, such consideration shall not be deemed a contribution as contemplated in this Article VIII.C.

D. Assignment; Maintenance of Uniform Interest:

For the purpose of maintaining uniformity of ownership in the Contract Area in the Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production covered by this agreement no party shall sell, encumber, transfer or make other disposition of its interest in the Oil and Gas Leases and Oil and Gas Interests embraced within the Contract Area or in wells, equipment and production unless such disposition covers either:

1. the entire interest of the party in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production; or

2. an equal undivided percent of the party's present interest in all Oil and Gas Leases, Oil and Gas Interests, wells, equipment and production in the Contract Area.

Every sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement and shall be made without prejudice to the right of the other parties, and any transferee of an ownership interest in any Oil and Gas Lease or Interest shall be deemed a party to this agreement as to the interest conveyed from and after the effective date of the transfer of ownership, provided, however, that the other parties shall not be required to recognize any such sale, encumbrance, transfer or other disposition for any purpose hereunder until thirty (30) days after they have received a copy of the instrument of transfer or other satisfactory evidence thereof in writing from the transferor or transferee. No assignment or other disposition of interest by a party shall relieve such party of obligations previously incurred by such party hereunder with respect to the interest transferred, including without limitation the obligation of a party to pay all costs attributable to an operation conducted hereunder in which such party has agreed to participate prior to making such assignment, and the lien and security interest granted by Article VII.B. shall continue to burden the interest transferred to secure payment of any such obligations.

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 require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for 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 party's interest within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the Oil and Gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds thereof.

26. Preferential Right to Purchase:

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an 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 interest therein.

27. F. Preferential Right to Purchase:

- (Optional; Check if applicable.)

Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed disposition, which shall include the name and address of the prospective transferee (who must be ready, willing and able to purchase), the purchase price, a legal description sufficient to identify the property, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after the notice is delivered, to purchase for the stated consideration on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to transfer title to its interests in mortgage in lieu of or pursuant to foreclosure of a mortgage of its interests, or to dispose of its interests by merger, reorganization, consolidation, or by sale of all or substantially all of its Oil and Gas assets to any party, or by transfer of its interests to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which such party owns a majority of the stock.

ARTICLE IX.

INTERNAL REVENUE CODE ELECTION

If, for federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, and if the parties have not otherwise agreed to form a tax partnership pursuant to Exhibit "G" or other agreement between them, each party thereby affected elects to be excluded from the application of all of the provisions of Subchapter "K," Chapter 1, Subtitle "A," of the Internal Revenue Code of 1986, as amended ("Code"), as permitted and authorized by Section 761 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Treasury Regulations §1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No such party shall give any notices or take any other action inconsistent with the election made hereby. If any present or future income tax laws of the state or states in which the Contract Area is located or any future income tax laws of the United States contain provisions similar to those in Subchapter "K," Chapter 1, Subtitle "A," of the Code, under which an election similar to that provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as may be permitted or required by such laws. In making the foregoing election, each such party that the income derived by such party from operations hereunder can be adequately determined without the computation of partnership taxable income.

ARTICLE X.

CLAIMS AND LAWSUITS

Operator may settle any single uninsured third party damage claim or suit arising from operations hereunder if the expenditure * * *** 67 does not exceed $______ Dollars ($______) 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.

See IV.B. ** **
Article VIII. ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST

F. PREFERENTIAL RIGHT TO PURCHASE (continued)

in the context of oil and gas transfers, contends that Article VIII.F. applies to package sales. Kutzschbach, Operating Agreement Considerations in Acquisitions of Producing Properties, 36th OIL & GAS INST. (Matthew Bender 1985), at 7-1. The definition will need to be tailored to the asset holdings of individual companies.

The preferential right provision should be retained if a party anticipates that it might wish to increase its interest in the JOA. 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 to the JOA is concerned about the entity that might purchase the interest, this provision can be used 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. In Exeter Exploration Co. v. Fitzpatrick, 661 P.2d 1255 (Mont. 1983) the court upheld the waiver of the preferential right provision. 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 parties to the JOA have a preferential right to purchase or a right of first refusal on the same terms offered by the prospective purchaser.

The last sentence has been amended to clarify that this provision does not apply to the "sale of all or substantially all of its Oil and Gas assets to any party." This clarifies an ambiguity in the 1982 Form which was likely a result of a punctuation error.

Article IX. INTERNAL REVENUE CODE ELECTION

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

Article X. CLAIMS AND LAWSUITS

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
 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 indemnify or make money payments or furnish security, 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 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, lighting, fire, storm, flood or other act of nature, 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.

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.

ARTICLE XII.

NOTICES

All notices authorized or required between the parties by any of the provisions of this agreement, unless otherwise specifically provided, shall be in writing and delivered in person or by United States mail, courier service, telegram, telex, teletypewriter or any other form of facsimile, postage or charges prepaid, and addressed to such parties at the addresses listed on Exhibit "A." All telephone or oral notices permitted by this agreement shall be confirmed immediately thereafter by written notice. The originating notice given under any provision hereof shall be deemed delivered only when received by the party to whom such notice is directed, and the time for such party to deliver any notice in response thereto shall run from the date the originating notice is received. "Receipt" for purposes of this agreement with respect to written notice delivered hereunder shall be actual delivery of the notice to the address of the party to be notified specified in accordance with this agreement, or to the telecopy, facsimile or telex machine of such party. The second or any responsive notice shall be deemed delivered when deposited in the United States mail or at the office of the courier or telegraph service, or upon transmission by telex, telecopy or facsimile, or when personally delivered to the party to be notified, provided, that when response is required within 24 or 48 hours, such response shall be given orally or by telephone, telex, telecopy or facsimile, or when personally delivered to the party to be notified, provided, that when response is required within 24 or 48 hours, the notice may be delivered in writing by any other method specified herein and shall be deemed delivered in the same manner provided above for any responsive notice.

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 the Completion of a well as a well capable of production of Oil and/or Gas in paying quantities, this agreement shall continue in force so long as such well is capable of production, and for an additional period of __________ days thereafter; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling, Reworking, Deepening, Sidelining, Plugging Back, testing or attempting to Complete or Re-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 capable of producing Oil and/or Gas from the Contract Area, this agreement shall terminate unless drilling, Deepening, Sidelining, Completing, Re-completing, Plugging Back or Reworking operations are commenced within __________ days from the date of abandonment of said well. "Abandonment" for such purposes shall mean either (i) a decision by all parties not to conduct any further operations on the well or (ii) the lapse of 180 days from the conduct of any operations on the well, whichever first occurs.

The termination of this agreement shall not relieve any party hereto from any expense, liability or other obligation or any remedy therefor which has accrued or attached prior to the date such termination.

Upon termination of this agreement and the satisfaction of all obligations hereunder, in the event a memorandum of this Operating Agreement has been filed of record, Operator is authorized to file of record in all necessary recording offices a notice of termination, and each party hereto agrees to execute such a notice of termination as to Operator's interest, upon request of Operator, if Operator has satisfied all its financial obligations.

ARTICLE XIV.

COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the applicable 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 laws 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
Article X. CLAIMS AND LAWSUITS (continued)

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. FORCE MAJEURE

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. 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. This provision now states that in addition to the payment of money, the obligation to indemnify and the furnishing of security shall not be affected by a force majeure event. This is a worthwhile addition. The new Form adds to the litany of force majeure events "or other acts of nature." As a consequence, the force majeure provision now covers, inter alia, earthquakes, volcanic eruptions and meteor showers.

Article XII. NOTICES

The 1989 Form clarifies that oral notices are to be "confirmed immediately" in writing, that originating notices are deemed delivered when received and that responsive notices are deemed delivered when deposited in the mail, deposited at the office of the courier or telegraph service, transmitted by telecommunications equipment or personally delivered.

It is a good practice to send notices Return Receipt Requested, keep the fax receipt information or employ some other method which will provide written evidence that a notice was sent. In appropriate circumstances, it may similarly be advisable to send change of address notices Return Receipt Requested, keep the fax receipt information or employ some other method which will provide written evidence that the notice was sent. If the notice period is shortened, it would be wise to also include fax numbers and a home address for weekends and holidays and a home 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
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 indemnify or make money payments or furnish security, 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 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, lighting, fire, storm, flood or other act of nature, 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.

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.

ARTICLE XII.

NOTICES

All notices authorized or required between the parties by any of the provisions of this agreement, unless otherwise specifically provided, shall be in writing and delivered in person or by United States mail, courier service, telegram, telex, teletypewriter or any other form of facsimile, postage or charges prepaid, and addressed to such parties at the addresses listed on Exhibit "A." All telephone or oral notices permitted by this agreement shall be confirmed immediately thereafter by written notice. The originating notice given under any provision hereof shall be deemed delivered only when received by the party to whom such notice is directed, and the time for such party to deliver any notice in response thereto shall run from the date the originating notice is received. "Receipt" for purposes of this agreement with respect to written notice delivered hereunder shall be actual delivery of the notice to the address of the party to be notified specified in accordance with this agreement, or to the telecopy, facsimile or telex machine of such party. The second or any responsive notice shall be deemed delivered when deposited in the United States mail or at the office of the courier or telegraph service, or upon transmittal by telex, telecopy or facsimile, or when personally delivered to the party to be notified, provided, that when response is required within 24 or 48 hours, such response shall be given orally or by telephone, telex, telecopy or other facsimile within such period. 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. If a party is not available to receive notice orally or by telephone when a party attempts to deliver a notice required to be delivered within 24 or 48 hours, the notice may be delivered in writing by any other method specified herein and shall be deemed delivered in the same manner provided above for any responsive notice.

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 hereunder, results in a dry hole, and no other well is capable of producing Oil and/or Gas from the Contract Area, this agreement shall terminate unless drilling, Deepening, Sidetracking, Completing, Re-completing, Plugging Back or Reworking operations are commenced within days from the date of abandonment of said well. "Abandonment" for such purposes shall mean either (i) a decision by all parties not to conduct any further operations on the well or (ii) the elapse of 180 days from the conduct of any operations on the well, whichever first occurs.

The termination of this agreement shall not relieve any party hereto from any expense, liability or other obligation or any remedy therefor which has accrued or attached prior to the date of such termination.

Upon termination of this agreement and the satisfaction of all obligations hereunder, in the event a memorandum of this Operating Agreement has been filed of record, Operator is authorized to file of record in all necessary recording offices a notice of termination, and each party hereto agrees to execute such a notice of termination as to Operator's interest, upon request of Operator, if Operator has satisfied all its financial obligations.

ARTICLE XIV.

COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the applicable 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
Article XII. NOTICES (continued)

the Operator has current addresses, fax numbers and phone numbers.

Article XIII. TERM OF AGREEMENT

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. Several revisions have been introduced which clarify issues that have surrounded Option No. 2. Under the 1982 Form, the term of the JOA is extended if a well "results in production of oil and/or gas in paying quantities." The 1989 Form revises this language to read "results in a Completion of a well as a well capable of production of Oil and/or Gas in paying quantities." This change clarifies the fact that a well need not be producing to perpetuate the JOA.

Conflicts have arisen regarding the term of the JOA, where a marginal well has been completed within the Contract Area, but is not producing and there is a question whether it will ever produce. Some parties want to perpetuate the JOA and others want to terminate the JOA. A new provision has been added that addresses this situation. A well is deemed "abandoned" and, consequently the JOA terminates, if the parties decide not to conduct any further operations on the well or 180 days elapse from the conduct of any operations on the well, whichever occurs first. Care must be exercised to ensure that a legitimately shut-in well waiting the construction of a pipeline or other facilities which shut-in period exceeds 180 days, does not trigger the termination of the JOA.

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 44 and line 51 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.

Pursuant to state law, a financing agreement must be released when the underlying security agreement terminates. This Form anticipates that a Memorandum of Operating Agreement and Financing Statement will have been executed and recorded. To aid in obtaining the requisite release or notice of termination, language has been added which provides that upon the termination of the JOA and the satisfaction of all debts, all parties will execute the notice of termination. The filing of a Notice of Termination could be expedited by providing that all parties agree that upon termination of the JOA and the satisfaction of all debts, the Operator is to file a release and termination or notice of termination. Admittedly, if the Operator has not satisfied its obligations, this recommendation gives the
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 indemnify or make money payments or furnish security, 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 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, lighting, fire, storm, flood or other act of nature, 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.

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.

ARTICLE XII.

NOTICES

All notices authorized or required between the parties by any of the provisions of this agreement, unless otherwise specifically provided, shall be in writing and delivered in person or by United States mail, courier service, telegram, telex, teletypewriter or any other form of facsimile, postage or charges prepaid, and addressed to such parties at the addresses listed on Exhibit "A." All telephone or oral notices permitted by this agreement shall be confirmed immediately thereafter by written notice. The originating notice given under any provision hereof shall be deemed delivered only when received by the party to whom such notice is directed, and the time for such party to deliver any notice in response thereto shall run from the date the originating notice is received. "Receipt" for purposes of this agreement with respect to written notice delivered hereunder shall be actual delivery of the notice to the address of the party to be notified specified in accordance with this agreement, or to the telecopy, facsimile or telegraph machine of such party. The second or any responsive notice shall be deemed delivered when deposited in the United States mail or at the office of the courier or telegraph service, or upon transmittal by telex, telecopy or facsimile, or when personally delivered to the party to be notified, provided, that when response is required within 24 or 48 hours, such response shall be given orally or by telephone, telex, telecopy or facsimile within such period. 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. If a party is not available to receive notice orally or by telephone when a party attempts to deliver a notice required to be delivered within 24 or 48 hours, the notice may be delivered in writing by any other method specified herein and shall be deemed delivered in the same manner provided above for any responsive notice.

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 the Completion of a well as a well capable of production of Oil and/or Gas in paying quantities, this agreement shall continue in force so long as any such well is capable of production, and for an additional period of _____________ days thereafter; provided, however, if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in drilling, Reworking, Deepening, Sidetracking, Plugging Back, testing or attempting to Complete or Re-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 capable of producing Oil and/or Gas from the Contract Area, this agreement shall terminate unless drilling, Deepening, Sidetracking, Completing, Re-completing, Plugging Back or Reworking operations are commenced within _____________ days from the date of abandonment of said well. "Abandonment" for such purposes shall mean either (i) a decision by all parties not to conduct any further operations on the well or (ii) the lapse of 180 days from the conduct of any operations on the well, whichever first occurs.

The termination of this agreement shall not relieve any party hereto from any expense, liability or other obligation or any remedy therefor which has accrued or attached prior to the date of such termination.

Upon termination of this agreement and the satisfaction of all obligations hereunder, in the event a memorandum of this Operating agreement has been filed of record, Operator is authorized to file of record in all necessary recording offices a notice of termination, and each party hereto agrees to execute such a notice of termination as to Operator's interest, upon request of Operator, if Operator has satisfied all its financial obligations.

ARTICLE XIV.

COMPLIANCE WITH LAWS AND REGULATIONS

A. Laws, Regulations and Orders:

This agreement shall be subject to the applicable 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
Article XIII. TERM OF AGREEMENT (continued)

Operator the authority to release the lien and security interest prematurely.

Article XIV. COMPLIANCE WITH LAWS AND REGULATIONS

A. LAWS, REGULATIONS AND ORDERS

The JOA is subject to all local, state and federal laws, ordinances, rules, regulations and orders.

B. GOVERNING LAW

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

This provision has not been changed, although the 1989 Form is printed in boldface type to comply with specific state statutes. For example, Section 35.53, of the TEXAS BUSINESS AND COMMERCE CODE mandates that "if any element of the execution" of a contract occurred in Texas and a party to the contract is a resident of, incorporated in, or has its principle place of business in Texas, and the contract provides that the laws of a state other than Texas apply, "the provision must be set out in boldface print." If, however, the provision is not set out in boldface print, the provision (not the entire contract) is voidable by a party against whom it is sought to be enforced.

C. REGULATORY AGENCIES

By execution of the JOA, the Non-Operator does not grant the Operator the right to waive or release any rights, privileges or obligations of the Non-Operator "under federal or state laws or under the rules, regulations or orders promulgated under such laws in reference to oil, gas and mineral operations . . . ." In light of Article XIV, can the Operator waive rights, privileges and obligations of the Non-Operators related to local laws, ordinances, rules, regulations and orders? Can the Operator waive the Non-Operator's rights, privileges and obligations of applicable federal, state and local laws, ordinances, rules regulations and orders if such are not promulgated "in reference to oil, gas and mineral operations"?
orders promulgated under such laws in reference to oil, gas and mineral operations, including the location, operation, or
production of wells, on tracts offering or adjacent to the Contract Area.

With respect to the 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 Federal Energy Regulatory Commission
or predecessor or successor agencies to the extent such interpretation or application was made in good faith and does not
constitute gross negligence. Each Non-Operator further agrees to reimburse Operator for such Non-Operator's share of
production or any refund, fine, levy or other governmental sanction that Operator may be required to pay as a result of such
incorrect interpretation or application.

ARTICLE XV.

MISCELLANEOUS

A. Execution:

This agreement shall be binding upon each Non-Operator when this agreement or a counterpart thereof has been
executed by such Non-Operator and Operator notwithstanding that this agreement is not then or thereafter executed by all of
the parties to which it is tendered or which are listed on Exhibit "A" as owning an interest in the Contract Area or which
own, in fact, an interest in the Contract Area. Operator may, however, by written notice to all Non-Operators who have
become bound by this agreement as aforesaid, given at any time prior to the actual spud date of the Initial Well but in no
event later than five days prior to the date specified in Article VI.A. for commencement of the Initial Well, terminate this
agreement if Operator in its sole discretion determines that there is insufficient participation to justify commencement of
drilling operations. In the event of such a termination by Operator, all further obligations of the parties hereunder shall cease
as of such termination. In the event any Non-Operator has advanced or prepaid any share of drilling or other costs
hereunder, all sums so advanced shall be returned to such Non-Operator without interest. In the event Operator proceeds
with drilling operations for the Initial Well without the execution hereof by all persons listed on Exhibit "A" as having a
current working interest in such well, Operator shall indemnify Non-Operators with respect to all costs incurred for the
Initial Well which would have been charged to such person under this agreement if such person had executed the same and
Operator shall receive all revenues which would have been received by such person under this agreement if such person had
executed the same.

B. Successors and Assigns:

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective heirs,
devises, legal representatives, successors and assigns, and the terms hereof shall be deemed to run with the Leases or
Interests included within the Contract Area.

C. Counterparts:

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

D. Severability:

For the purposes of assuming or rejecting this agreement as an executory contract pursuant to federal bankruptcy laws,
this agreement shall not be severable, but rather must be assumed or rejected in its entirety, and the failure of any party to
this agreement to comply with all of its financial obligations provided herein shall be a material default.

ARTICLE XVI.

OTHER PROVISIONS
Article XIV. COMPLIANCE WITH LAWS AND REGULATIONS

C. REGULATORY AGENCIES (continued)

The Non-Operators agree to release and indemnify the Operator for all good faith interpretations of rules, rulings, regulations and orders of the Department of Energy and the Federal Energy Regulatory Commission.

Article XV. MISCELLANEOUS

A. EXECUTION

The provision addressing execution attempts to cure the age old problem of a well spudding before the JOA is fully executed. While this practice is universally agreed to be bad, many wells spud without a fully executed JOA. This provision institutes several new rules. The JOA is binding as to those who execute the document, notwithstanding that it is not fully executed by the parties listed on Exhibit "A." Although not so stated, a revised Exhibit "A" should be created on an acreage ownership basis within the Contract Area. The Operator can, by written notice, terminate a JOA if it is not fully executed (at any time prior to the actual spud date of the Initial Well, but in no event later than five days prior to the date specified for commencement of the Initial Well) if the Operator in its sole discretion determines there is insufficient participation to justify drilling. If the operations are terminated, all obligations are extinguished and all money advanced must be returned, without interest. If, however, the Operator proceeds with drilling operations for the Initial Well and the JOA has not been fully executed, the Operator must "indemnify Non-Operators with respect to all costs incurred for the Initial Well which would have been charged to such person under this agreement if such person had executed the same and Operator shall receive all revenues which would have been received by such person under this agreement if such person had executed the same." In Somont Oil Co., Inc. v. Nutter, 743 P.2d 1016 (Mo. 1987) the court held that the parties' performance could substantiate the existence of a JOA which was never fully entered into. In Neeley v. Intercity Management Corp., 732 S.W.2d 644 (Ct. App. Tx. 1987) the court held that a JOA is not necessary to vest the operating cotenant under a common leasehold with the right to recover daily production and marketing expenses.

How extensive is the definition of the word "indemnify"? Is it limited by the term "with respect to all costs incurred for the Initial Well . . . ."? In addition to paying drilling, completing, equipping and operating costs, is the Operator also responsible for ensuring that interest of each Non-Operator in production remains at the level specified in the original Exhibit "A"?
orders promulgated under such laws in reference to oil, gas and mineral operations, including the location, operation, or
production of wells, on tracts offering or adjacent to the Contract Area.

With respect to the 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 Federal Energy Regulatory Commission
or predecessor or successor agencies to the extent such interpretation or application was made in good faith and does not
constitute gross negligence. Each Non-Operator further agrees to reimburse Operator for such Non-Operator's share of
production or any refund, fine, levy or other governmental sanction that Operator may be required to pay as a result of such
incorrect interpretation or application.

ARTICLE XV.
MISCELLANEOUS

A. Execution:
This agreement shall be binding upon each Non-Operator when this agreement or a counterpart thereof has been
executed by such Non-Operator and Operator notwithstanding that this agreement is not then or thereafter executed by all of
the parties to which it is tendered or which are listed on Exhibit "A" as owning an interest in the Contract Area or which
own, in fact, an interest in the Contract Area. Operator may, however, by written notice to all Non-Operators who have
become bound by this agreement as aforesaid, given at any time prior to the actual spud date of the Initial Well but in no
event later than five days prior to the date specified in Article VI.A. for commencement of the Initial Well, terminate this
agreement if Operator in its sole discretion determines that there is insufficient participation to justify commencement of
drilling operations. In the event of such a termination by Operator, all further obligations of the parties hereunder shall cease
as of such termination. In the event any Non-Operator has advanced or prepaid any share of drilling or other costs
hereunder, all sums so advanced shall be returned to such Non-Operator without interest. In the event Operator proceeds
with drilling operations for the Initial Well without the execution hereof by all persons listed on Exhibit "A" as having a
current working interest in such well, Operator shall indemnify Non-Operators with respect to all costs incurred for the
Initial Well which would have been charged to such person under this agreement if such person had executed the same and
Operator shall receive all revenues which would have been received by such person under this agreement if such person had
executed the same.

B. Successors and Assigns:
This agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective heirs,
devises, legal representatives, successors and assigns, and the terms hereof shall be deemed to run with the Leases or
Interests included within the Contract Area.

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

D. Severability:
For the purposes of assuming or rejecting this agreement as an executory contract pursuant to federal bankruptcy laws,
this agreement shall not be severable, but rather must be assumed or rejected in its entirety, and the failure of any party to
this agreement to comply with all of its financial obligations provided herein shall be a material default.

ARTICLE XVI.
OTHER PROVISIONS
Article XV. MISCELLANEOUS

A. EXECUTION (continued)

What if the Operator does not personally have enough production to give a Non-Operator sufficient production to equal what he would have been entitled, had the JOA been executed by every party listed in Exhibit "A"? For example, assume that the Contract Area consists of 160 acres, being the NE/4. ARCO owns the NE/NE. Exxon owns the SE/NE. Chevron owns the SW/NE. And ARCO and Oryx jointly own the NW/NE, ARCO owning an undivided 10% and Oryx owning an undivided 90%. Oryx never executes the JOA. A prolific well is drilled in the NW/NE on a 40 acre drilling and spacing unit by ARCO, as Operator. Does Exxon and Chevron earn an interest in the NW/NE by virtue of ARCO's undivided 10% interest? I assume they do. Is ARCO liable to Exxon and Chevron for the production they would have received had ARCO obtained Oryx's signature on the JOA? I assume that the indemnity is only limited to costs; and, consequently, ARCO is not liable to Exxon and Chevron for the production they would have received had Oryx executed the JOA.

B. SUCCESSORS AND ASSIGNS

The 1989 Form clearly states that the terms and obligations of the JOA are not personal but rather run with the Leases or Interests. While this recitation is nice, it does not bind subsequent bona fide purchasers for value, that are not aware of particular burdens or encumbrances. It would be advisable for assignees to ratify the JOA. In Pasternak v. Lear Petroleum Exploration, Inc., 790 F.2d 828 (10th Cir. 1986) the court held that a farmee was bound by the terms of a JOA that had been executed by the farmor. It is advisable to obtain a novation, whenever an assignment is made wherein the parties to the JOA would agree to the addition or replacement of a new party and the new party would ratify the JOA, on agreed terms.

Alternatively, the assignment provision could be amended as follows:

Notwithstanding any provision hereof to the contrary, no party shall assign or otherwise transfer all or any portion of any oil and gas interest or oil and gas lease now or hereafter subject to this agreement without first obtaining the written consent of [all the parties] [a majority in interest of the other parties], whose consent shall not be withheld unreasonably.
orders promulgated under such laws in reference to oil, gas and mineral operations, including the location, operation, or production of wells, on tracts offering or adjacent to the Contract Area.

With respect to the 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 Federal Energy Regulatory Commission or predecessor or successor agencies to the extent such interpretation or application was made in good faith and does not constitute gross negligence. Each Non-Operator further agrees to reimburse Operator for such Non-Operator's share of production or any refund, fine, levy or other governmental sanction that Operator may be required to pay as a result of such incorrect interpretation or application.

ARTICLE XV.

MISCELLANEOUS

A. Execution:

This agreement shall be binding upon each Non-Operator when this agreement or a counterpart thereof has been executed by such Non-Operator and Operator notwithstanding that this agreement is not then or thereafter executed by all of the parties to which it is tendered or which are listed on Exhibit "A" as owning an interest in the Contract Area or which own, in fact, an interest in the Contract Area. Operator may, however, by written notice to all Non-Operators who have become bound by this agreement as aforesaid, given at any time prior to the actual spud date of the Initial Well but in no event later than five days prior to the date specified in Article VI.A for commencement of the Initial Well, terminate this agreement if Operator in its sole discretion determines that there is insufficient participation to justify commencement of drilling operations. In the event of such a termination by Operator, all further obligations of the parties hereunder shall cease as of such termination. In the event any Non-Operator has advanced or prepaid any share of drilling or other costs hereunder, all sums so advanced shall be returned to such Non-Operator without interest. In the event Operator proceeds with drilling operations for the Initial Well without the execution hereof by all persons listed on Exhibit "A" as having a current working interest in such well, Operator shall indemnify Non-Operators with respect to all costs incurred for the Initial Well which would have been charged to such person under this agreement if such person had executed the same and Operator shall receive all revenues which would have been received by such person under this agreement if such person had executed the same.

B. Successors and Assigns:

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective heirs, devisees, legal representatives, successors and assigns, and the terms hereof shall be deemed to run with the Leases or Interests included within the Contract Area.

C. Counterparts:

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

D. Severability:

For the purposes of assuming or rejecting this agreement as an executory contract pursuant to federal bankruptcy laws, this agreement shall not be severable, but rather must be assumed or rejected in its entirety, and the failure of any party to this agreement to comply with all of its financial obligations provided herein shall be a material default.

ARTICLE XVI

OTHER PROVISIONS
Article XV. MISCELLANEOUS

B. SUCCESSORS AND ASSIGNS (continued)

If the parties wish to ensure that the assignor remains liable for its share of the expenses, the following language could be incorporated:

In addition, no such assignment or transfer shall be effective unless and until the assignee or transferee agrees in writing to take the assigned or transferred interest subject to this agreement and to assume its proportionate share of all obligations and restrictions created by this agreement with respect to the interest assigned or transferred from the effective date thereof, and copies of such written agreement have been delivered to the parties. Notwithstanding any provision hereof to the contrary and unless waived in writing by each of the non-transferring parties, the assigning or transferring party shall remain jointly and severally liable with the assignee or transferee to the parties hereto for the performance and satisfaction of all obligations attributable to the interest assigned or transferred, whether such obligation arises before or after the effective date of the assignment or transfer. The provisions of this paragraph shall not apply to any transfer by operation of law or the grant of a mortgage or security interest in any oil and gas interest subject to this agreement but shall apply to any transfer of legal title to such interest pursuant to or in lieu of any such mortgage or security interest.

C. COUNTERPARTS

To expedite the approval and signature process, counterpart executions are now explicitly recognized.

D. SEVERABILITY

This new provision attempts to prohibit a bankruptcy court from assuming (or rejecting) only a part of the JOA. This provision unambiguously states that "[f]or the purpose of assuming or rejecting this agreement as an executory contract pursuant to federal bankruptcy laws, this agreement shall not be severable." This reference was incorporated to address the situation where the bankrupt debtor contends that the JOA is not an executory contract and therefore, it need not be assumed in its entirety. This situation occurred in *In re Price*, 71 Bankr. Rep. 341 (N.D. Okla. 1987), where the federal district court held that a debtor did not need to cure its pre-bankruptcy default before participating in a post-bankruptcy
orders promulgated under such laws in reference to oil, gas and mineral operations, including the location, operation, or
production of wells, on tracts offering or adjacent to the Contract Area.

With respect to the 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 Federal Energy Regulatory Commission
or predecessor or successor agencies to the extent such interpretation or application was made in good faith and does not
constitute gross negligence. Each Non-Operator further agrees to reimburse Operator for such Non-Operator's share of
production or any refund, fine, levy or other governmental sanction that Operator may be required to pay as a result of such
incorrect interpretation or application.

ARTICLE XV.
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own, in fact, an interest in the Contract Area. Operator may, however, by written notice to all Non-Operators who have
become bound by this agreement as aforesaid, given at any time prior to the actual spud date of the Initial Well but in no
event later than five days prior to the date specified in Article VI.A. for commencement of the Initial Well, terminate this
agreement if Operator in its sole discretion determines that there is insufficient participation to justify commencement of
drilling operations. In the event of such a termination by Operator, all further obligations of the parties hereunder shall cease
as of such termination. In the event any Non-Operator has advanced or prepaid any share of drilling or other costs
hereunder, all sums so advanced shall be returned to such Non-Operator without interest. In the event Operator proceeds
with drilling operations for the Initial Well without the execution hereof by all persons listed on Exhibit "A" as having a
current working interest in such well, Operator shall indemnify Non-Operators with respect to all costs incurred for the
Initial Well which would have been charged to such person under this agreement if such person had executed the same and
Operator shall receive all revenues which would have been received by such person under this agreement if such person had
executed the same.

B. Successors and Assigns:
This agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective heirs,
devises, legal representatives, successors and assigns, and the terms hereof shall be deemed to run with the Leases or
Interests included within the Contract Area.

C. Counterparts:
This instrument may be executed in any number of counterparts, each of which shall be considered an original for all
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D. Severability:
For the purposes of assuming or rejecting this agreement as an executory contract pursuant to federal bankruptcy laws,
this agreement shall not be severable, but rather must be assumed or rejected in its entirety, and the failure of any party to
this agreement to comply with all of its financial obligations provided herein shall be a material default.

ARTICLE XVI
OTHER PROVISIONS
Article XV. MISCELLANEOUS

D. SEVERABILITY (continued)

subsequent operation. The court reasoned that the subsequent operations provisions of the JOA are independent of the remaining contract provisions, so that the curing of the pre-bankruptcy default was not required.

In addition, to aid in dealing with insolvent parties, new language was added to provide that "the failure of any party to this agreement to comply with all of its financial obligations provided herein shall be a material default." This language may also be helpful in removing an Operator pursuant to the "good cause" standard in Article V.B.
orders promulgated under such laws in reference to oil, gas and mineral operations, including the location, operation, or production of wells, on tracts offering or adjacent to the Contract Area.

3. With respect to the 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 Federal Energy Regulatory Commission or predecessor or successor agencies to the extent such interpretation or application was made in good faith and does not constitute gross negligence. Each Non-Operator further agrees to reimburse Operator for such Non-Operator's share of production or any refund, fine, levy or other governmental sanction that Operator may be required to pay as a result of such incorrect interpretation or application.

ARTICLE XV.
MISCELLANEOUS

A. Execution:
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B. Successors and Assigns:
This agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective heirs, devisees, legal representatives, successors and assigns, and the terms hereof shall be deemed to run with the Leases or Interests included within the Contract Area.

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

D. Severability:
For the purposes of assuming or rejecting this agreement as an executory contract pursuant to federal bankruptcy laws, this agreement shall not be severable, but rather must be assumed or rejected in its entirety, and the failure of any party to this agreement to comply with all of its financial obligations provided herein shall be a material default.

ARTICLE XVI.
OTHER PROVISIONS

AUTHOR'S NOTE

Many Operating Agreements do not contain Article XVI. provisions. Frequently, there is no need to include any additional provisions. The suggested Article XVI. provisions address specific instances where the parties wish to amend and revise the Operating Agreement or where the parties wish to supplement the Operating Agreement.
# Article XVI. OTHER PROVISIONS

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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. (if Option No. 1 in Article VI.C.1. is selected), 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 ____________ (____) days (inclusive of Saturday, Sunday and legal holidays) 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 ____________ (____) days (inclusive of Saturday, Sunday and legal holidays) of the receipt of such request if a drilling rig is on location and within ____________ (____) days (inclusive of Saturday, Sunday and legal holidays) 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.

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
Article XVI. OTHER PROVISIONS

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 VI.C.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 ________ (____) days (inclusive of Saturday, Sunday and legal holidays) from receipt of such second request.

If a Non-Operator fails to pay or furnish the aforesaid security within ________ (____) days (inclusive of Saturday, Sunday and legal holidays) 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 ________ (____) days (inclusive of Saturday, Sunday and legal holidays) 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 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 VI.C.1.) not to participate in such operation.
Article XVI. OTHER PROVISIONS

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 _________ (______) days (exclusive of Saturday, Sunday and legal holidays) 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 _________ (______) days (exclusive of Saturday, Sunday and legal holidays) 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 canceled, and if the canceled Drilling Operation involves the drilling of a test well under Article VI.A., no assignment shall be due as a consequence 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 Well under Article VI.A., Non-Operator shall be deemed to relinquish all such Non-Operator's interest in the Drilling 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.

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 a specified rate per annum.

ADVANCE OF WELL COSTS -- INTEREST AND RELINQUISHMENT

Notwithstanding any other provisions herein, Operator shall have the right to request and receive from each Non-Operator payment in advance of its
Article XVI. OTHER PROVISIONS

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. (if Option No. 1 in Article VI.C.1. is selected), (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 __________ (____) days (inclusive of Saturday, Sunday and legal holidays) 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 __________ (____) days (inclusive of Saturday, Sunday and legal holidays) of the receipt of such request if a drilling rig is on location and within __________ (____) days (inclusive of Saturday, Sunday and legal holidays) 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 depositing Non-Operator with interest on the funds on deposit during such month at the rate of __________ 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
Article XVI. OTHER PROVISIONS

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 _______ (_______) days (inclusive of Saturday, Sunday and legal holidays) from receipt of such second request.

If a Non-Operator fails to pay or furnish the aforesaid security within _______ (_______) days (inclusive of Saturday, Sunday and legal holidays) 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 _______ (_______) days (inclusive of Saturday, Sunday and legal holidays) 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 (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 VI.C.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
Article XVI. OTHER PROVISIONS

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 ___________ (____) days (inclusive of Saturday, Sunday and legal holidays) 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 ___________ (____) days (inclusive of Saturday, Sunday and legal holidays) 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 canceled, and if the canceled Drilling Operation involves the drilling of a test well under Article VI.A., no assignment shall be due as a consequence of the failure to pay or furnish the aforesaid security as provided above.
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B. 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 ____________, 19____, 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 the party selected to retain custody of all escrow funds (hereinafter "Escrow Agent") as follows:

1. On or before ____________, 19____, 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 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:

1. 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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2. 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.

3. 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 ________________.

4. 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.

5. 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.

6. 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.

7. 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
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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.

8. 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.

9. 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.

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

11. 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: _______________________

__________________________
(Print or Type Name)

Title: _______________________

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DATE:  By: ________________________________

______________________________________
(Print or Type 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.

DATE:  BANK

______________________________________  By: ________________________________

______________________________________
(Print or Type Name)

Title: ________________________________

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.
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C. The 1989 Form has adopted the concepts incorporated in this provision. If, however, the parties elect to use a JOA other than the 1989 Form, consideration should be given to including this provision as it 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, Sidetracking, 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, upon ______________ (______) days (inclusive of Saturday, Sunday and legal holidays) prior written notice of its intention 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 __________ (____) day period; however, the penalty amounts provided for in Article VI.B.2.(b) shall be __________ percent (____%). 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.

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.
Article XVI. OTHER PROVISIONS

D. 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.

OBLIGATORY WELL -- WITH OPPORTUNITY TO EXTEND OR RENEW

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., 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.

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.
Article XVI. OTHER PROVISIONS

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.

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., 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 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.

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 changed only in Exhibit "A" to indicate 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.
Article XVI. OTHER PROVISIONS

E. The relinquishment (blackout) provisions below provide powerful incentives for a party to seriously consider participating in a well.

RELINQUISHMENT PROVISION -- EXPLORATORY WELL

Notwithstanding anything to the contrary, any party may, at any time propose the drilling of a well pursuant to Article VI.B. The party proposing a well shall deliver an executed AFE to the other parties. The non-proposing parties shall have \( n \) days (inclusive of Saturday, Sunday and legal holidays) 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 where 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 and assign to the Drilling Party or Parties one hundred percent (100\%) of its right, title and interest in the Drilling Unit and the eight (8) Drilling Units directly and diagonally offsetting the Drilling Unit upon which the well was drilled.

RELINQUISHMENT PROVISION -- ALL WELLS

Notwithstanding anything to the contrary, in the event that any party hereto elects not to participate in the drilling of a well pursuant to Article VI.B., that party shall promptly relinquish and assign, upon Completion of the drilling of such well, to the parties who drilled such well, one hundred percent (100\%) of its right, title and interest in the Drilling Unit and the eight (8) Drilling Units directly and diagonally offsetting the Drilling Unit upon which the well was drilled.

Because of the expense and risk of drilling horizontal wells, the inclusion of relinquishment or farmout provisions should be considered. In nearly all instances, all parties will participate in the drilling of the Initial Well. As to subsequent horizontal wells, however, the parties will usually have the right to elect not to participate. In such a case, the parties may wish to modify the standard non-consent provisions contained in the JOA by including the more stringent provision, as proposed herein. Both examples distinguish between non-participation in a horizontal exploratory well and a horizontal development well. Under the farmout provision, a party electing not to participate in a horizontal exploratory well must
Article XVI. OTHER PROVISIONS

farmout his interest in the Drilling Unit upon which the well is proposed and, in addition, must farmout his interest in all Drilling Units which are diagonal and direct offsets thereto, except as to those offsets which are at that time locations for horizontal development wells.

Where a party elects not to participate in the drilling of a horizontal development well or in a vertical well, the non-consent provisions contained in the JOA will control. As discussed previously in connection with Article VI.B., in these instances the percentage penalties for a horizontal development well may be set high. As discussed previously, in connection with Article VI.C., Option No. 1 should be checked when the drilling of horizontal wells are anticipated. If the parties intend to drill both vertical wells and horizontal wells, Option No. 1 should be checked and designated that it is applicable only to horizontal wells. Option 2 should also be checked and designated that it is applicable only to vertical wells.

RELINQUISHMENT PROVISION -- HORIZONTAL WELL

For purposes of this agreement, the parties agree to the following definitions:

1. "Horizontal Well" shall mean an Oil or Gas well in which the actual or proposed horizontal component of the gross Completion interval in the reservoir exceeds the vertical component of such gross Completion interval.

2. "Horizontal Exploratory Well" shall mean a Horizontal Well proposed to be drilled on a Drilling Unit that is neither a direct nor a diagonal offset to a Drilling Unit upon which is located a Horizontal Well producing in paying quantities from the same formation as proposed for said well.

3. "Horizontal Development Well" shall mean a Horizontal Well proposed to be drilled on a Drilling Unit that is either a direct or a diagonal offset to a Drilling Unit upon which is located a Horizontal Well producing in paying quantities from the same formation as proposed for said well.

In the event any party to this agreement elects not to participate in a Horizontal Exploratory Well which is proposed pursuant to Article VI.B., such non-participating party shall, upon commencement of
Article XVI. OTHER PROVISIONS

operations for said well, relinquish to the participating party one hundred percent (100%) of its right, title and interest in and to that portion of the Contract Area included within the Drilling Unit for such well and one hundred percent (100%) of such party's right, title and interest in and to that portion of the Contract Area included within the Drilling Units for two direct Horizontal Development Well offsets to such well, such offsets to be selected by the participating parties within thirty (30) days (inclusive of Saturday, Sunday and legal holidays) from rig release of said well.

If the participating parties agree to curtail drilling operations on a Horizontal Exploration Well prior to reaching the proposed horizontal targeted total measured distance described in the notice proposing the well for any reason, including but not limited to the encountering of granite or practically impenetrable substance or other condition in the hole rendering further other operations impracticable, or if the participating parties agree to drill to a greater horizontal distance than the proposed horizontal targeted total measured distance described in the notice proposing the well, non-participating parties whether or not they submitted or voted for an alternative proposal under Article VI.B. to drill the well to a lesser proposed horizontal targeted total measured distance or to a greater proposed horizontal targeted total measured distance under the notice under which the well was drilled shall not have the right to participate in the initial proposed Completion of the well or any future Recompletion and the relinquishment provisions of Article VI.B.2.(b) shall not apply to such party's interest.

The relinquishment of interest, subject to the recoupment of the specified percentages of costs described in Article VI.B.2.(b), shall apply to Horizontal Developmental Wells.
Article XVI. OTHER PROVISIONS

F. The parties to the JOA could elect to replace the non-consent provisions which would apply to a proposal to drill a well with a 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 (inclusive of Saturday, Sunday and legal holidays) after the expiration of the thirty (30) days (inclusive of Saturday, Sunday and legal holidays) (or as promptly as possible after the expiration of the forty-eight [48] hour [inclusive of Saturday, Sunday and legal holidays] 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: (1) request Operator to perform the work required by such proposed operation for the account of the Consenting Parties, or (2) 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.

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 (inclusive of Saturday, Sunday and legal holidays) after receipt of such notice, shall advise the proposing party of its desire to: (1) limit participation to such party's interest as shown on Exhibit "A" or (2) carry its proportionate part of Non-Consenting Parties' interest, and failure to advise the proposing party shall be deemed an election under (1). 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, at its election, may withdraw such proposal if there is insufficient
Article XVI. OTHER PROVISIONS

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, risk and expense and the well shall be turned over to the Operator and shall be operated by the Operator 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 Drilling 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 and 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 Drilling 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
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of each Non-Consenting Party's right, title and interest in and to the well, the Leases covering the lands included within the Drilling Unit for the well and its share of production from the well, from the surface of the ground down to one hundred feet (100') below the stratigraphic equivalent of the total depth drilled in the well. Each Non-Consenting Party shall accept 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.

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 (inclusive of Saturday, Sunday and legal holidays) 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 paragraph 2, below.

1. Non-Consenting Party elects to convert its overriding royalty interest to a proportionately reduced _________ percent (______ %) working interest in the well, the production therefrom and the Leases covering the lands contained in the Drilling Unit for the well. Said election to be effective the day following the day payout occurs. The Consenting Parties, within thirty (30) days (inclusive of Saturday, Sunday and legal holidays) 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 this Article, payout for any well shall be deemed to occur when the cumulative market value of production from the well (after
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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 percent (100%) 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 percent (100%) of the actual cost of operating the well during the payout period.

FARMOUT -- HORIZONTAL WELLS

For purposes of this agreement, the parties agree to the following definitions:

1. "Horizontal Well" shall mean an Oil or Gas well in which the actual or proposed horizontal component of the gross Completion interval in the reservoir exceeds the vertical component of such gross Completion interval.

2. "Horizontal Exploratory Well" shall mean a Horizontal Well proposed to be drilled on a Drilling Unit that is neither a direct nor a diagonal offset to a Drilling Unit upon which is located a Horizontal Well producing in paying quantities from the same formation as proposed for said well.

3. "Horizontal Development Well" shall mean a Horizontal Well proposed to be drilled on a Drilling Unit that is either a direct or a diagonal offset to a Drilling Unit upon which is located a Horizontal Well producing in paying quantities from the same formation as proposed for said well.

Should any party elect not to participate in any Horizontal Exploratory Well, other than the Initial Well, proposed under the terms of this agreement, the non-participating party agrees to farmout to the participating parties its interest, under the Farmout Agreement attached hereto and designated as Exhibit "H". The Farmout shall be effective upon commencement of drilling operations and shall cover the Drilling Unit upon which the proposed Horizontal Exploratory Well is located, as well as all Drilling Units which are direct or diagonal offsets thereto (except those direct or diagonal offsets which are at such time locations for Horizontal Development Wells). The Farmout will be on a drill-to-earn basis such that the participating parties
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shall earn an assignment of the non-participating party's interest in the farmed out acreage on a well-by-well basis, from the surface of the ground down to the base of the objective formation drilled, and covering in each instance the Drilling Unit upon which such well is located. If the well drilled by the participating parties is completed as a producer, the non-participating party shall reserve in such assignment the right to a reassignment of a ______ percent (_____%) working interest, proportionately reduced to the interest originally assigned, at payout. Payout shall be calculated on a well-by-well basis. The Farmout shall allow one (1) year between the Completion of drilling operations on one Horizontal Well and the commencement of drilling operations on the next Horizontal Well until all of the Drilling Units farmed out have been drilled, or until the Farmout otherwise terminates.

In the event a proposed Horizontal Exploratory Well is not timely commenced or is not drilled as proposed, the effect shall be as if the proposal had not been made and the Farmout shall have no further force and effect.

Should any party elect not to participate in any Horizontal Development Well, or in any vertical well, proposed under the terms of this agreement, the non-participating party's interest shall be subject to the non-consent provisions contained in Section VI.B.2 of this agreement.
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G. 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 -- FINANCIAL

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 __________ 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 total cost 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 __________ percent (_______%).] Within thirty (30) days (inclusive of Saturday, Sunday and legal holidays) 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, 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.2. 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
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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 drilling operation is proposed according to the provisions of Article VI.B.1., 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 well is excessive, and said party is willing to drill, Complete and/or equip the proposed well at a cost of at least ________% 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 a breakdown of the total cost associated with the drilling, Completing and/or equipping of the 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 party(s) supporting the replacement of the Operator shall own a combined working interest in the Contract Area equal to or greater than ________%.] 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.

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, redrilling 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,
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whether similar or dissimilar. Upon Completion by successor Operator of all drilling, Completing, and/or equipping operations on the 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.

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.

Change of Operator -- Dilution of Interest

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 (inclusive of Saturday, Sunday and legal holidays) 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 (inclusive of Saturday, Sunday and legal holidays) 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 (inclusive of Saturday, Sunday and legal holidays) 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 (inclusive of Saturday, Sunday and legal holidays) 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.
H. There is a wide divergence of opinion in the industry with regard to the use of priority of operations or sequence of operation provisions. 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. The 1989 Form adopts this second, and I believe preferable, approach. Prior operating agreements do not address this issue. A priority of operations provision is offered. If the form of JOA being used is not the 1989 Form and a priority of operations provision is desired, substitute the recommended language or some variation thereof for Article VI.B.6.

**Priority of Operations**

Where a well authorized under the terms of this agreement by all parties (or by less than all parties 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 hereinafore 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
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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 logs, cores, or results of the tests, but shall suffer no other penalty.
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I. The 1989 Form provides throughout that where lands that were initially subject to the JOA are excluded from the JOA, the "parties who elect to participate shall be subject to this agreement but shall be deemed subject to a separate Operating Agreement in the form of this agreement." Previous versions of the JOA do not, however, include such a provision. To so amend a pre-1989 Form, include such language in the body of the agreement or incorporate the following in Article XVI. By so doing, potentially prolonged negotiations over the adoption of a JOA will be avoided.

LANDS EXCLUDED FROM THE OPERATING AGREEMENT

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.
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J. 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 (including re-entry for Deepening or Sidetracking an abandoned 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: (1) 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 (2) 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.
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K. If the parties enter into a JOA which encompasses open acreage or there is a possibility that the area of interest to the parties extends beyond the Contract Area, the parties may wish to include an Area of Mutual Interest (AMI). I recommend a derivation of the suggested provision.

AREA OF MUTUAL INTEREST

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 agreement remains in effect, unless sooner terminated by the parties.

During the term of this AMI, if any party hereto ("Acquiring Party") acquires any Oil and Gas Leases or any interest therein, any mineral interest or any farmouts or other contracts with respect thereto which affect lands and minerals lying within the AMI, 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 Oil and Gas Interest in accordance with the other provisions of this AMI.

Promptly upon acquiring such Oil and Gas 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 Oil and Gas Interest. The Acquiring Party shall also enclose an itemized statement of the actual costs and expenses incurred by the Acquiring Party in acquiring such Oil and Gas Interest, excluding, however, costs and expenses of its own personnel ("Acquisition Costs"). Each Offeree shall have a period of ________ (______) days (inclusive of Saturday, Sunday and legal holidays) 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 Oil and Gas Interest. If, however, a well in search of Oil or Gas is being drilled within the AMI or at a location outside the AMI of which the result could be expected to materially affect the value of the offered Oil and Gas Interest, each Offeree shall have a period of ________ (______) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of the notice within which to elect to acquire its proportionate interest in the Oil and Gas Interest so offered. It is provided, however, that the ________ (______) hour (exclusive of Saturday, Sunday and legal holidays) election
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period shall not apply unless the Acquiring Party shall give the notice to the Offerees within __________ (_____ hours (exclusive of Saturday, Sunday and legal holidays) after the date on which the Acquiring Party acquired the Oil and Gas Interest so offered. In addition thereto, the Acquiring Party shall also:

(1) 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

(2) specifically advise the Offeree that the Offeree shall have a period of __________ (_____ hours (exclusive of Saturday, Sunday and legal holidays) within which to elect to acquire an interest in the offered Oil and Gas 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 an Oil and Gas 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 __________ (_____ day (inclusive of Saturday, Sunday and legal holidays) or __________ (_____ hour (exclusive of Saturday, Sunday and legal holidays) period, as the case may be, such failure shall constitute an election by such Offeree not to acquire its interest in the Oil and Gas Interest. Each Offeree accepting the offered Oil and Gas Interest shall be entitled to participate in such Oil and Gas 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 Oil and Gas 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 __________ (_____ days (inclusive of Saturday, Sunday and legal holidays) 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 __________ (_____ hours (exclusive of Saturday, Sunday and legal holidays) after receipt of such notice by the delinquent
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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 Oil and Gas Interest. Unless the delinquent party pays the amount due within said __________ (____) hour (exclusive of Saturday, Sunday and legal holidays) period provided for in said written notice, the delinquent party shall have no right to acquire an interest in the offered Oil and Gas Interest.

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. 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.

If the Oil and Gas Interest covers lands both within and without the AMI, the Acquiring Party may, at its option, offer either the entire Oil and Gas Interest, or only the portion of the Oil and Gas 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 Oil and Gas Interest offered bears to the total Oil and Gas Interest acquired. If the entirety of the premises covered by the Oil and Gas 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 Oil and Gas Interest, the Oil and Gas Interest so acquired shall not be subject to this agreement, but shall be subject to an operating agreement on a form identical to this agreement (without this Area of Mutual Interest provision) between the parties hereto who acquire an interest in such Oil and Gas Interest. If less than all the parties acquired their proportionate interest in a Oil and Gas Interest which is included in a Drillsite, Exhibit "A" to this agreement shall be revised to reflect the proportionate ownership on an acreage basis within the Drillsite.
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L. Occasionally, the parties to a JOA anticipate conducting geoscience operations on the Contract Area. The following provision provides an orderly procedure for the proposing of geoscience operations:

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 thereof, purchase of seismic, geophysical, geochemical or geologic information, interpretations thereof 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 ____________(______) days (inclusive 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 ____________(______) 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 Party, within __________(______) hours (exclusive of Saturday, Sunday and legal holidays) after receipt of such notice shall
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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 this 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 Operator shall commence such geoscience operation within __________ (__) days (inclusive of Saturday, Sunday and legal holidays) 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 __________ (__) 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 any party who elects not to participate in such geoscience operation thereafter desires to receive the data generated from such geoscience operation, such party may, by first paying to the parties who have participated in such geoscience operation, a sum equal to __________ percent (______%) of the amount such non-participating party would have paid had such non-participating party originally participated in said prior geoscience operation. Thereupon, such party(s) shall then be entitled to receive information, data and materials obtained from the geoscience operation,
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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 the premiums as provided for above.

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 engaged in bona fide negotiations to conclude a farmout or a purchase) or 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 this agreement, that information or income shall be shared based on the proportionate interest of each party who participated in the geoscience operation.

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.
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M. 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 is 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. Once again, the 1989 Form anticipates and addresses this issue and, consequently, this provision is not needed if using the 1989 Form.

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 (inclusive of Saturday, Sunday and legal holidays) from the date an order for relief is entered under the Bankruptcy Code as to the rejection or assumption of this agreement in its entirety. 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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N. MEMORANDUM OF OPERATING AGREEMENT AND FINANCING STATEMENT

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. 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.

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 (UCC) without significant revision, many states have adopted the UCC 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.

This lien and security interest gives the parties to the JOA a right to sell the property of a defaulting party in order to obtain money for the payment of expenses. This sale may occur under the supervision of the court or non-judicially, depending upon the terms of the contract and the extent to which state law will allow non-judicial foreclosure.

In the past, it has not been customary in the oil and gas industry for Operators to record liens and security interests arising under the JOA. Recently, however, a slumping economy, falling oil prices and governmental regulation have caused an increasing number of bankruptcies and an increasing incidence of delayed payment or non-payment of expenses by parties to JOAs.

Generally, persons with like interests in the property of a debtor stand an equal chance of recovering a judgment in their favor. However, procedures exist by which creditors can give their interests priority over the interests of other creditors. For example, an unrecorded security interest is subordinate to the interests of creditors who have taken steps to perfect their interests. In addition, under real property laws, the holder of an unrecorded lien will lose his lien if the debtor transfers his property to a purchaser for value who does not know there is a lien on the property.

Thus, absent recordation, the rules governing debtor and creditor relationships reduce the value of lien and security interest rights in proportion to the number of creditors with like claims on the property of the debtor. It is essential that the
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oil and gas interest owner understand the means available to a creditor for protecting his rights and gaining the highest possible priority for his claims. Recording security interests and liens may also give added force to demands for payment and may provide the necessary leverage for obtaining payment from a debtor who has not yet reached insolvency.

The value of lien and security interests can be augmented by following the procedures established by statute for providing notice to other creditors of a prior lien or security interest. The theory behind such laws is that a creditor cannot be allowed to complain about a risk he knowingly assumes.

To protect JOA liens and security interests, some commentators have suggested filing the JOA in the real property records of the county where the operations are performed. Recording the JOA will provide notice to the purchaser for value that the property he is acquiring is subject to a lien. Likewise, the trustee in bankruptcy acquires the property with notice of the lien, so that the property enters the bankruptcy estate subject to the lien. The recorded JOA may also give the parties 'perfected' status under the UCC, thereby giving the holders priority over creditors with unperfected security interests in the same property.

On the other hand, the JOA is a lengthy document which is expensive to file, and may contain confidential or semi-confidential terms which the parties do not want to place on public display. The JOA is not acknowledged in most instances, and generally must be acknowledged to qualify for recordation. Because the JOA fails to meet some of the formalities required by the UCC for an enforceable financing statement, it must be modified before filing. In addition, there is some risk that the JOA is insufficient as a financing statement to cover all types of property subject to lien and security interest provisions in states requiring special requirements in the case of collateral which is, or will become, fixture. Finally, the JOA may not provide notice of all matters that the parties would like to place of record. For example, filing the JOA alone will not prevent contracts for assignment of future interests within the Contract Area (such as farmout contracts) from being avoided by the trustee in bankruptcy. The disadvantages to filing the JOA are sufficiently great to warrant consideration of alternative methods of providing notice.

The ideal protection for the parties is a relatively brief instrument (a memorandum) which can be filed in state and county records to: (1) provide notice of liens on real property; (2) perfect security interests in all personal property and fixtures; and (3) provide notice of transfers of equitable interests in property to which legal title will be assigned in full at a later date. To accomplish these objectives, the instrument
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must meet the requirements of a financing statement under the UCC, and must be a sufficient memorandum of the JOA to satisfy notice requirements under state real property law. The instrument should also contain a clause which provides notice of equitable interests held by the parties to the JOA under farmout contracts.

Two distinct property rights are granted in the JOA: (1) a lien upon real property; and (2) a security interest in tangible and intangible personal property and fixtures. The effect of the lien is governed by the real property laws of the state where the operations are conducted, whereas the effect of the security interest is governed by the UCC.

The specific property covered will depend upon the terms of the JOA, and in part, upon the scope the court and the parties are willing to give to the JOA provisions once financing trouble has occurred.

The use of broad categories of property in the JOA increases the risk that a defaulting party will assert that specific items of property were not included, and increases the risk that a court will find that the parties intended to exclude items from the provisions. Although it may be undesirable to list property in detail in the JOA, the property can be delineated in detail on the Memorandum in order to make the rights of all parties to the agreement more certain.

Potentially, the security interest provision could cover all extracted oil and gas stored on the Contract Area, all equipment and other personal (moveable) property used in connection with operations, all accounts, contract rights and other intangibles held by the parties in connection with operation, all proceeds from the sale of property covered by the security interest and all fixtures on the Contract Area.

The lien covers oil and gas before extraction, in those states which recognize private ownership of oil and gas before extraction, often referred to as "oil or gas in place." The lien can also cover any leases or absolute ownership of mineral rights in the Contract Area, and to some extent, fixtures within the Contract Area.

Statutes in some states provide for a lien on after-acquired property, i.e., a lien on interests in property acquired by the debtor after the lien date. When no statute either provides for or prohibits a lien on after-acquired property in a jurisdiction and the after-acquired property falls within the mortgage description, it can generally be included in a mortgage unless prohibited by judicial decision. Judicial decisions in a majority of states have upheld the validity of such a provision as between the parties, although liens on after-acquired property are often refused priority as to
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third-parties, even if recorded.

The UCC recognizes the validity of an after-acquired property provision in a security agreement, with certain exceptions relating to consumer goods. An after-acquired property clause in the security agreement gives the secured party an interest in existing and future assets which fall within the scope of collateral described in the security agreement.

Although it is not necessary to specifically describe after-acquired property in the security agreement or financing statement when the obvious purpose of the provision is to cover something which by its nature changes from time-to-time (i.e., accounts and inventory), the particular class of collateral should be specified. Classes of property that could be included in the Memorandum include oil and gas to be extracted at a later date, assignments of farmout rights, accounts, fixtures, real property and personal property acquired within the Contract Area or in furtherance of the purposes of the JOA.

However, it should be noted that attempts to use a financing statement to expand rights under a security agreement (i.e., by including an after-acquired property clause in the financing statement although the security instrument does not cover after-acquired property), have been declared invalid. As to the debtor's purchasers and other creditors, a financing statement may be used to restrict the security interest created by the security agreement (i.e., perfected interests in less than all of the collateral), but cannot be used to enlarge the security interest. Thus, in order to make the Memorandum effective as a financing statement as to after-acquired property, the security interest provision in the JOA must be amended to encompass after-acquired property.

UCC article 9 governs security interests as defined by the UCC. The term security interest is defined as "an interest in personal property or fixtures which secures payment or performance of an obligation;" however, UCC 9-102(1)(c) provides that article 9 shall apply "to any transaction, regardless of its form, which is intended to create a security interest in personal property or fixtures." Thus, article 9 applies only to contractual security interests, and only to interests in personal property and fixtures. The JOA, which creates a contractual interest in personal property and fixtures to secure payment or performance of an obligation, is a security interest within the meaning of the UCC.

The UCC provides that such interests are enforceable under the code if: (1) the debtor has signed a security agreement which contains a description of the
collateral; (2) value has been given; and (3) the debtor has rights in the collateral. Upon execution by the parties, the JOA meets these requirements for enforceability and the interest "attaches" immediately.

Article 9-312 allows the holder of a valid security interest to "perfect" his interest. "Perfection" is UCC terminology for the process of providing notice to all creditors of security interests in property. The UCC prescribes the formalities required to provide notice and indicates the place of filing such notice. These requirements vary slightly from state to state, but are satisfied in every state by filing a financing statement.

The basic provisions of UCC article 9-402(1) must be met in all states. A financing statement must contain: (1) the name of the debtor; (2) the name of the secured party; (3) the signature of the debtor; (4) the address of the secured party from which information concerning the secured interest may be obtained; (5) the mailing address of the debtor; and (6) a statement indicating the types [classes] or describing the items of collateral.

In the case of the JOA, each party is a potential debtor and a potential creditor of each other party. To meet the requirements of article 9-402(1), the Memorandum must contain the names of all parties, the signatures of all parties and the addresses of all parties from which information concerning the security interest can be obtained. The mailing address of a party must be included, if different from the above address, and a list of property used as collateral must be provided.

In addition to the basic requirements above, the requirements of article 9-402(5) must be met when collateral is fixtures or minerals, including oil and gas. In this regard, filing the JOA alone may be insufficient as a financing statement.

Article 9-402(5) requires that the financing statement must: (1) indicate that it covers fixtures or minerals and the like; (2) recite that it is to be filed in the real estate records; (3) include a description of the real estate sufficient, if it contained a mortgage, to give constructive notice of the mortgage under the laws of the state; and (4) include the name of the record owner of the real estate, if the debtor does not have an interest of record in the real estate where the minerals and fixtures are located.

Because the JOA security interest covers both fixtures and minerals, it is essential to meet the requirements of article 9-402(5) when drafting the Memorandum. The
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Model Memorandum includes a statement that it covers fixtures and minerals, and that it is to be filed in the real estate records. In addition, there is space for the required property description. The UCC requires only that the property description comply with the state's laws prescribing the requisites of a property description for a mortgage. Thus, a description sufficient to provide notice of the lien is also sufficient to meet UCC requirements. The difficult issue in applying article 9-402(5) is accommodating the requirement that the financing statement contain the name of the record owner of the real estate. Must all record owners be specified? If so, who are the record owners (Lessees? Farmors? Owners of title to the minerals?)

In order to perfect a security interest in collateral other than real property, including fixtures, it is necessary to file a financing statement in the proper place(s). UCC article 9-401, as adopted by the various states, governs the place(s) of filing. The proper place of filing varies with the types of collateral covered. Thus, for the Memorandum, which covers real and personal property and fixtures to be effective as to all property types, it must be filed in several places.

The proper place to file when collateral is minerals or the like (including oil and gas) or when the financing statement is filed as a fixture filing and the collateral is goods which are or are to become fixtures is in the office where a mortgage on the real estate concerned would be filed or recorded. For all other types of collateral, with the exception of farm products and consumer goods, the UCC requires an additional centralized filing in the office of the Secretary of State, or other office designated to handle UCC records.

Several states have added an additional filing requirement based upon the location of the debtor's place of business. These states also provide for filing a financing statement when the debtor has no place of business in the state. It is important to remember in this regard that all parties to the Memorandum are potential debtors and must be considered such in determining the proper place to file the financing statement.

A financing statement terminates after five years unless a continuation statement is filed during the six-month period prior to the end of the five-year term. Because most of the risk involved in joint operations on oil and gas property generally occurs in the early period of development, before production is obtained, parties may not deem it worthwhile to install the necessary system to track the running of financing statements. However, if the continuation of the security interest is desired, parties can file a continuation statement and extend the period of perfection of the security
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interest five years from the "last date to which the [prior] filing was effective."
Succeeding continuation statements can be filed in the same manner.

The continuation statement must express the intention of the parties to continue the
effect of the financing statement. In addition, the statement must contain the file
number of the original financing statement and the signature of the parties. The
execution date of the continuation statement may be included for the reference of the
parties; however, the continuation will not become effective until the date of filing.

It is possible that the parties to the Memorandum could consent in advance to the
filing of a continuation by the Operator, to be binding on all parties to the
Memorandum when filed. This procedure, if enforceable against all parties, would
avoid the inconvenience of circulating the continuation statement for the signature of
all the parties. The Model Memorandum grants the Operator the right to file
continuation statements; the A.A.P.L. Form does not.

Once the debtor has satisfied all outstanding secured obligations, he may make
demand upon the secured party for a termination statement. The purpose of the
termination statement is to provide notice that the debtor's personal property and
fixtures are no longer encumbered. The UCC requires a secured party to comply
with the demand by sending the debtor a termination statement within ten days.
Failure to comply results in liability for specified statutory damages. A copy must be
provided for each filing officer with whom the financing statement was filed. The
termination statement must state that the secured party no longer claims a security
interest under the financing statement, and must identify the financing statement by
file number.

Once a party has met all his obligations under the JOA, he is eligible to demand a
termination statement from each party to the JOA. To simplify the process of
terminating his interests, the Model Memorandum provides that a party may make
demand upon the Operator, who will then file a termination statement on behalf of all
parties to the JOA. By agreeing in advance (when the parties execute the
Memorandum) such a procedure will prevent any party from claiming an interest in
the debtor's property after the date of filing of the termination statement. Likewise,
the fact that the debtor has consented to the arrangement should act as a waiver of his
right to assert statutory damages against any Non-Operator for failure to file an
independent termination statement. The A.A.P.L. Form does not contain such a
provision.
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Any assignment of security interests which occurs prior to termination must be considered when a termination statement is filed. Thus, the Operator must attach to the termination statement a copy of the assignment, if any, made to any current party to the JOA, but not yet placed of record as provided in UCC article 9-405. It would also be advisable to reference in the termination statement the names of the other parties to the Memorandum, and state that the termination statement is filed by the Operator pursuant to and on behalf of all parties to the Memorandum.

The UCC provides that a financing statement substantially complying with Code requirements is effective even though it contains minor errors that are not seriously misleading. Accordingly, minor changes in circumstances will not invalidate a financing statement which is otherwise valid. Nevertheless, when circumstances change so substantially that the financing statement would be materially misleading to creditors, it is necessary to file an amendment.

Because the Memorandum may be filed before payout in a farmout situation, the Memorandum must be amended at payout to include the name of the farmor if he elects to convert to a working interest. The Memorandum would also require amendment if the Contract Area is enlarged, or if some other material change in collateral occurs.

The UCC provides for amendment of financing statements, but does not specify any particular amendment process. The procedure under UCC article 9-405 for providing notice of assignments is indicative of the type of procedure which should be followed when amending the financing statement.

A "Financing Statement" is defined in the UCC as the original financing statement plus any amendments thereof. Presumably, then, there is no need to file an entirely new financing statement each time the financing statement is amended. On the other hand, it would be unreasonable to allow one party, unilaterally, to change the financing statement terms without the consent of the other parties. The amendment should, at a minimum, contain the signatures of all the parties who are potential debtors under the JOA, the file number of the original financing statement, the date of the original financing statement, and the printed names of the parties. It would be advisable for all parties to execute an amendment. If for no other reason, a solvent company today may be insolvent tomorrow.

Although assignment of a security interest by a secured party would seem to require amendment of the financing statement, the UCC provides a procedure for placing assignments of record. The assignee must file a written statement of assignment
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(either the assignment document itself or a separate instrument). The statement must be signed by the secured party of record and the debtor, contain the file number and date of the original financing statement, provide the name and address of the assignee, and describe the collateral assigned. The statement must be filed in each place that the financing statement is filed.

For most purposes, the Memorandum will be sufficient without amendment, and in the rare case where amendment is necessary, it will not be unduly burdensome to obtain the signatures of the parties for such amendment. Nevertheless, when it is anticipated that a farmor or other person with interests in the Contract Area will subsequently become a party to the JOA and the Memorandum, it will be more convenient for the parties to consent in advance to the ratification of the Memorandum by other parties holding an interest in the Contract Area.

A ratification, signed by a new party, will serve two purposes. First, by ratifying the Memorandum, the ratifying party will enter into the Memorandum as a potential debtor/creditor. In this sense the ratification will act as an amendment to the financing statement when it is filed in the UCC records. The ratification when filed will also act as notice that the ratifying party has subjected his property to the lien in the JOA. A document of ratification can be drafted in advance to serve these purposes.

The Operating Agreement provides that "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 "mutual or like lien" granted by the Operator confers the same rights on the Non-Operators. The rights and remedies of a secured party, in bankruptcy and non-bankruptcy situations, are found in UCC articles 9-501 through 9-507. The secured party's rights include the right to take possession of collateral when the debtor is in default, either through self-help repossession, or through judicial action. The UCC provides procedures for handling notice, repossession, sale, and deficiency (or excess) from sale. Careful attention should be paid to the procedures outlined in the Code.

A party to a JOA may have a contractual farmout right to drill on certain property in the Contract Area. This farmout right differs from a mineral interest (working interest) such as an oil and gas lease, and therefore raises special concerns.

If a farmor goes bankrupt after the assignment of the mineral interest occurs and after the assignment has been properly acknowledged and recorded, the transfer is
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not voidable by creditors of the farmor or a trustee in bankruptcy who have claims arising after the farmor files for bankruptcy. If the assignment is not recorded or if the assignment has not yet taken place, the trustee in bankruptcy may have the power to void the transfer. This can be devastating for the farmee who has invested substantial resources in the drilling of the well at the time of filing.

1. Powers of a Trustee in Bankruptcy

Section 541 of the bankruptcy code provides in pertinent part:

(a) The commencement of a case... creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal equitable interests of the debtor in property as of the commencement of the case.

(b) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest... becomes property of the estate of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

Under section 541, standing alone, it can be argued that a farmee holds a present equitable interest in the minerals covered by the contract prior to assignment. That interest would not become a part of the bankruptcy estate and would entitle the farmee to an assignment of legal title to the minerals once he has performed his obligations to drill. If the assignment has taken place prior to filing for bankruptcy, the assigned property would not become a part of the bankruptcy estate.

However, under section 544 of the bankruptcy code the trustee has the power (commonly referred to as "strong arm powers") to avoid certain transfers made, or to be made, by the debtor after the petition for bankruptcy is filed.
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Section 544 provides in pertinent part:

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or any creditors, the rights and powers of, or may avoid any transfer of the property of the debtor or any obligation incurred by the debtor that is voidable by -- . . . .

(3) A bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such purchaser exists.

The extent to which the trustee can exercise these powers is governed by state law. Under the real property laws of most states, a transfer of real property which is not recorded can be avoided by a bona fide purchaser (BFP) for value unless that BFP has knowledge of the transfer. Similarly, a contractual encumbrance on property, including a contract to assign in the future, can be avoided, even though it may be an obligation which runs with the land, if that contract is not recorded properly. In the farmout context, 544(a) appears to allow the bankruptcy trustee to avoid both unrecorded assignments of oil and gas interests and contracts for future assignment of legal title.

2. The Relation Between Section 544 and Section 541

As illustrated above, unrecorded assignments and contracts to assign may be capable of being avoided by the trustee in bankruptcy. Therefore, an argument can be made that the bankrupt estate includes all mineral interests that have not been assigned and recorded. This would be true whether the farmout contract is viewed as a covenant to assign at a future date, or as a present assignment of equitable title to the minerals. On the other hand, under section 541, it would appear that any equitable interests assigned prior to commencement of bankruptcy are not a part of the bankruptcy estate. Very little case law addresses the interrelation of these two statutes and the effect.
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The most commonly accepted view is that section 541 was not intended to proscribe the strong arm powers of the bankruptcy trustee under section 544. Under such an approach, equitable interests assigned prior to bankruptcy will become a part of the bankruptcy estate unless they are recorded in order to prevent the trustee, as a BFP, from avoiding the transfer or unless the Trustee chooses not to avoid the transfer.

The bankruptcy court in its decision of In re Partners Oil Co., Case No. 83-015 787-H3-5 (unpublished opinion), was faced with the issue of whether to grant a preliminary injunction to prevent the trustee from including certain royalty and leasehold interests in the bankruptcy estate. The court stated:

Industry practice and good reason exist to warrant the retention of legal title to oil and gas leases by the Operator (such as the Debtor) even though the equitable title in the leases are held by others. For example, it is important for the Debtor-Operator to retain legal title to:

a. efficiently sell the production from the wells;

b. efficiently police defaults by investors;

c. avoid unnecessary filings if the well is not commercially productive;

d. efficiently enter into pooling and unitization agreements;

e. efficiently pay taxes on the property; and

f. avoid holding up development until all leases are purchased.

Accordingly, section 541(d) applies to the oil and gas industry as regards the questions now before the Court. Pursuant to section 541(d), the equitable interests owned by the individuals and entities listed on Exhibits "1" and "2" are not and shall not become, pursuant to section 544 or otherwise, property of the estate of the Debtor.
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Whether the case will ultimately be decided under this "industry practice" theory, whether the theory would apply in a farmout situation and whether other courts would follow this approach is not certain.

Courts have generally held that the trustee, under section 544(a), may avoid a transfer of property if such property is voidable by a BFP for value under state law. A number of courts have entertained the argument that an equitable or constructive trust should be created for the benefit of the unrecorded interest holders. With rare exception, bankruptcy courts, however, have not applied the constructive trust theory, but have held that the trustee's rights under section 544(a) are superior to those of an unrecorded interest holder who has an equitable interest in the property. The court in In re Fieldcrest Homes, 18 B.R. 678 (Bankr. N.D. Ill. 1982), ruled that constructive trusts can be enforced against a bankruptcy trustee, notwithstanding his status as a BFP pursuant to section 544(a)(3), and if a constructive trust were to be imposed, the trustee would only hold bare legal title to the property for the benefit of the beneficiaries.

A farmout could be viewed as an offer which is accepted by performance. If the farmee does not drill and fulfill its contractual commitments, it will not earn an interest in the minerals. Unless the farmout explicitly provides that the farmee must commence or complete operations by a specified date, the farmee can walk away from the farmout without incurring any liability. Conversely, under this theory, until the offer is accepted by the farmee's performance, the farmor can withdraw its offer and the farmout will terminate. Until the offer has been accepted by the farmee's commencement of performance, the farmout can be terminated by either the farmor or the farmee. Once the farmee begins performance, the farmout agreement becomes an irrevocable offer to assign after full performance has occurred, and the farmout is no longer an executory contract. However, once the offer has been accepted, the farmout becomes an executory contract and is subject to the section 541/544 conflict.

Another problem arises because of the bankruptcy trustee's power under section 365 to accept or reject executory contracts. In states where an oil and gas lease does not represent ownership of a real property interest in oil and gas "in place," the farmout contract will be viewed as an agreement to assign a personal property interest at some future date. If performance of the obligations of the farmee is not sufficient to prevent the contract from being classified as executory, then the bankruptcy trustee has the power to
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reject the contract. If the farmout is rejected as an executory contract, the farmee loses his interest. If a state recognizes ownership of oil and gas "in place," however, then section 365(i) may allow the farmee to retain possession after the debtor or trustee rejects the contract, perform his drilling operations, and receive an assignment of legal title.

The following language can be inserted on Exhibit A to the Memorandum in order to provide notice that land within the Contract Area is subject to a farmout contract:

On _______, 19__, __________ (farmer) entered into a Farmout Agreement entitling ___________ (farmee), a party to the Memorandum of Operating Agreement, to a present equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Agreement covers the following acreage: _________

The area covered by the farmout is described with sufficient definiteness to put any party reading the Memorandum on notice, and should obligate him to inquire into the particular terms of farmout agreements which his assignor may have granted. This notice recites that the farmout was considered by the parties to be a present assignment of equitable title and, consequently, the agreement should not be subjected to being avoided by the bankruptcy trustee. The trustee has constructive notice and should not be able to avoid the farmout by claiming it did not have notice and under its powers of a BFP it can avoid the farmout. In addition, the farmout agreement may be less likely to be viewed as an executory contract if the record notice states that the farmee has been given "a present equitable interest . . . with legal title to be assigned at a later date."

Filing a Memorandum to record liens and perfect security interests in offshore properties may be more academic than practical given that historically most parties to such operations have been financially stable, and given that bonding and other security measures are taken by the parties to such an operation before beginning work. However, should the parties wish to file a Memorandum the place of filing will depend largely upon whether the lease involved is on federal or state lands.
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The UCC as adopted by the states governs perfection of security interests in fixtures and personal property on an offshore lease. UCC article 9 provisions would be pre-empted if federal law regulated the entire field of liens and security interests in a given class of property. The Mineral Land Leasing Act (MLLA), 30 U.S.C. §§ 181-287 (1988), Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331-1356 (1988), and Outer Continental Shelf (OCS) Leasing Program, which address only operations, safety and title considerations of federal leases, do not regulate the perfection of liens and security interests. The filing provisions of the UCC would be inapplicable if federal law provided for a comprehensive system of filing on a national basis. Since the MLLA, OCS Leasing Program and rules and regulations implementing those programs, do not provide for a comprehensive system of securing liens and security interests, a secured party should take the precaution of filing as required by the UCC and as allowed in the federal files.

Many states provide for filing in the county where a mortgage on the real estate would be filed. Because offshore leases do not fall within county boundaries, it has become customary among Operators who file JOAs to file in the county adjacent to the coastal area where the Contract Area is located. The same approach can be followed when filing the Memorandum. In the onshore context, the Memorandum should be recorded in the county or counties where the Contract Area is located. In addition, the Memorandum should be filed in the office of the Secretary of State or other centralized filing location specified in the UCC.

The MLLA requires filing of certain interest in federal Oil and Gas Leases with the federal Bureau of Land Management (BLM). No uniform procedures for filing of security agreements, financing statements, mortgages, or deeds of trust have been specified by the BLM. The regulations address only assignment of leaseholds and production payments. Nevertheless, some BLM offices will accept security instruments for filing, and filing, when allowed, would be a good practice to follow given that the lease and JOA will be on file with the BLM state office with jurisdiction over the leased lands. BLM offices are open to the public with a few enumerated exceptions based upon confidentiality of the information on file.

Under the OCS Leasing Program, filings must be made with the Mineral Management Service (MMS) regarding operations. Some MMS offices might be willing to accept security instruments for filing, even if they are not "recognized" as far as the government is concerned.
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Farmout agreements, JOAs and other agreements which contain language immediately conveying record title, operating rights, overriding royalties, production payments or some other interest in the lease constitute an "assignment" and must be filed with the BLM and/or MMS offices, on approved forms.

MLLA regulations give BFP for value special protection, but whether filings in the BLM and MMS offices constitute notice is unsettled.

The Wyoming Supreme Court, in Dame v. Mileski, 340 P.2d 205 (Wyo. 1959), held that filing of an assignment of an overriding royalty with the (federal) land office was not constructive notice when it was not recorded in the office of the register of deeds of the county. Similarly, the 10th Circuit, in Bolack v. Underwood, 340 F.2d 816 (10th Cir. 1965), decided that when the New Mexico statute provided for recording of federal oil and gas leases in the county clerk's office, filing in the BLM office was not notice of a prior assignment of a federal lease.

In Page v. Fees-Krey, Inc., 617 P.2d 1188 (Colo. 1980), however, the Colorado Supreme Court distinguished Dame and Bolack holding that where the assignor has no interest of record in the federal lease in the county records, no reasonable reliance could be founded upon the state of title as reflected in the county records, so that the assignee is put on inquiry notice of assignments recorded in the BLM files.

To ensure that notice is effective, the Memorandum should be filed in the office where the mortgage on the real estate would be filed under state law.

State "Public Lands" statutes govern the filing of leases and assignments of leases of state land in the offshore area. By way of illustration, consider the Texas public land statutes. The Texas Natural Resources Code, Sections 52.011-52.034 provide for lease of submerged lands of the Gulf of Mexico within the jurisdiction of Texas, for oil and gas operations.

Section 31.011 provides that there shall be one General Land Office, which shall be located in Austin and which shall register all land titles emanating from the State. Section 31.052 states that documents relating to land titles shall be kept in the General Land Office in Austin. Section 52.026, however, mandates that the transfer of a lease shall be recorded in the county in which all or a part of the lease area is located and, within 90 days after the
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execution of the transfer, the recorded transfer or a certified copy of the recorded transfer in the General Land Office.

Given the requirements of Section 52.026, the Memorandum would probably be ineffective as notice to third parties in Texas if filed only in the General Land Office. The Memorandum must be filed in the county records as well. The statutes will vary from state to state and must be consulted before filing the Memorandum.

As previously discussed, perfecting security interests in property on a leasehold from the state involves filing a financing statement as required by UCC article 9-401. Financing statements concerning interests in minerals and fixtures must be filed in the office of the Secretary of State or other centralized location provided for by the statute. The statement must also be filed in the office where a mortgage on the real estate would be filed. It may also be possible/desirable to file in the office where leases from the state are recorded (such as the General Land Office in Texas). Call the state leasing office for information on whether they accept such documents for filing.

CONCLUSION

Although Article VII.B. provides that all executing parties grant one another liens and security interests to secure payment of the parties' proportionate share of expenses, without recording these liens and security interests, they may well be worthless. The recording of a Memorandum will secure and perfect the lien and security interest. And if a brief mention of the farmout is included in the Memorandum, a farmee may be able to protect its farmout rights. If employed, this relatively simple and inexpensive procedure can positively affect the sleep habits of working interest owners. See Derman, Protecting Oil and Gas Lien and Security Interests: Use of Memorandum of Operating Agreement and Financing Statement, A.B.A. Natural Resources Law Section Monograph No. 6 (1987), for a more comprehensive analysis and recommended forms that have been tailored to meet the requirements of the laws of all 50 states. Once again, the forms recommended herein do not comply with the laws of every state. Individual state law must be reviewed to ensure that the forms meet the requirements of state law.
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O. Where the Operator has technology which is patented, patentable, proprietary or where such technology is subject to an agreement where a third party has restricted the disclosure of such technology, the Operator may need to or desire to restrict the disclosure of such technology. The suggested language can be used to restrict such disclosure.

PROPRIETARY TECHNOLOGY -- HORIZONTAL WELL

It is understood by the parties that this agreement is being entered into with the expectation that one or more horizontal well may be drilled within the Contract Area. For purposes of this provision "Horizontal Well" shall mean an Oil or Gas well in which the actual or proposed horizontal component of the gross Completion interval in the reservoir exceeds the vertical component of such gross Completion interval.

It is recognized that certain horizontal drilling techniques, processes and equipment which may be utilized by Operator, or which may be utilized by third parties with whom Operator contracts on a proprietary and confidential basis, as well as all data and information collected from the use of such techniques, processes and equipment, or arising at a future date from same, either because of agreements or techniques existing at the effective date of this agreement or because of techniques developed by Operator, or agreements entered into after the execution of this agreement, are confidential and proprietary to Operator.

Accordingly, it is hereby agreed that notwithstanding anything contained in this agreement to the contrary, any process, information, equipment or data that is, or may become, of a proprietary and confidential nature to Operator, either through contract or by its own endeavors regarding the exploration for or the drilling of Horizontal Wells shall be and remain the sole property and information of Operator (and where appropriate, the party with whom it has contracted for such proprietary and confidential process, information, equipment or data); and such process, information, equipment or data shall not be divulged to the other parties hereto until such time as said contract or proprietary right shall expire or until Operator shall deem such information to be public knowledge (either under the terms of such existing agreement or by its own pronouncement). In addition, at any time or times as any proprietary and confidential processes, techniques or equipment are being utilized, Operator may restrict the parties' access to the Contract Area.
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P. As discussed previously, it may be desirable to limit Non-Operator's financial expenditure by giving the Non-Operator the ability to go non-consent on expenditures that exceed the approved AFE plus a specified amount. This concept appeared in an early version of the 1989 Form, but was ultimately abandoned by the drafters.

COST OVERRUNS

When Operator in good faith believes that the actual costs for any Drilling, Reworking, Sidetracking, Deepening or Plugging Back operation conducted under this agreement will exceed __________ percent (_________%) of the costs estimated for such operation on the approved AFE, Operator will give prompt notice by telephone to the other parties participating in such operation and will deliver a supplemental AFE estimating the costs necessary to complete such operation and stating Operator's recommendation as to continuation of the operation or conducting a different operation on the well. Each party receiving such supplemental AFE shall have forty-eight (48) hours (inclusive of Saturday, Sunday and legal holidays) from receipt to elect to approve Operator's recommendation or propose an alternative operation; failure by a party to respond within such period shall be deemed an election to approve Operator's recommendation. If any party proposes an alternative operation, it shall deliver notice of such alternative to all other parties participating in such well within the period required to respond to Operator. The other parties shall have forty-eight (48) hours (inclusive of Saturday, Sunday and legal holidays) from their receipt of such alternative proposals to notify Operator if they elect to participate in such alternative proposal or to approve Operator's recommendations; each such notice shall specify whether such party elects to: (1) participate in one or more of the proposals and (2) bear not only its proportionate share of the cost of any alternative proposal but also its share of the cost of any party electing to become a Non-Consenting Party as to such operation and its share of the cost of any Consenting Party who does not elect to bear its share of the cost of any Non-Consenting Party.

If there is not agreement for bearing the cost of one hundred percent (100%) of the continuing the original operation or conducting an alternative operation, Operator shall terminate the operation and plug and abandon the well as quickly and inexpensively as practicable under the circumstances, and the participating parties shall pay their proportionate shares of the remaining costs incurred by Operator. If there is agreement for bearing one hundred
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percent (100%) of the cost of either continuing the original operation or conducting one or more alternative operations, the provisions of Article VI.B.2. shall apply so that the parties continuing operations on such well beyond the end of the election period shall own all the interest in the well of the parties electing to terminate their participation until the Consenting Parties have recouped the percentages of costs specified in Article VI.B.2.(b) of continuing the operation beyond the end of the election period. The operation conducted by the Consenting Parties shall be conducted pursuant to a supplemental AFE prepared by the Operator. Thereafter, if Operator in good faith believes that the actual costs of the operation will exceed the costs estimated in the supplemental AFE by the same percentage as provided in the above paragraph for the initial cost overrun, Operator shall give notice to the parties still participating in such operation, in like manner and with like effect as provided above for the first notice of overrun.

Operator's failure to give the notice required by this provision shall not subject Operator to any liability for excessive costs so long as such failure was not the result of gross negligence or willful misconduct.

Nothing contained herein shall be construed to permit any party to terminate its liability for its share of costs resulting from a blowout or a well out of control or other emergency that causes costs to exceed the above-stipulated percentage of the approved AFE until Operator has regained control of the well or otherwise overcome the emergency.
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Q. To ensure that the Operator has a direct financial stake in the operations, it may be advisable to provide that if the Operator's interest in the JOA falls below a specified percentage, the Operator shall be deemed to have resigned.

REMOVAL OF OPERATOR -- FINANCIAL INTEREST

Subject to Article V.B.2., Operator shall be deemed to have resigned if its interest as set out in Exhibit "A" of this agreement is less than __________%.

Although the Operator will certainly object, in certain situations it may be desirable to include a provision which acts to remove an Operator if a specific number and percentage of the parties wish to do so, without regard to any fault of the Operator. This provision can be especially helpful in removing an Operator that is experiencing financial difficulties, prior to the initiation of bankruptcy proceedings, which in most instances will insulate the insolvent Operator from the immediate claims of its creditors including those of the Non-Operators. A similar provision was included in early drafts of the 1989 Form. Although many companies vehemently oppose such a provision for U.S. onshore operations, the removal without cause appears in many U.S. offshore operating agreements.

REMOVAL OF OPERATION -- WITHOUT CAUSE

Subject to Article V.B.2., Operator may be removed at any time without cause by the affirmative vote of ______ or more of the total number of Non- Operators owning at least _______% of the interest as set out in Exhibit "A."
IN WITNESS WHEREOF, this agreement shall be effective as of the ___ day of ________________.

ATTEST OR WITNESS:

OPERATOR

By ________________________________

______________________________

Type or print name

Title ________________________________

Date ________________________________

Tax ID or S.S. No. ________________________________

NON-OPERATORS

By ________________________________

______________________________

Type or print name

Title ________________________________

Date ________________________________

Tax ID or S.S. No. ________________________________

By ________________________________

______________________________

Type or print name

Title ________________________________

Date ________________________________

Tax ID or S.S. No. ________________________________

By ________________________________

______________________________

Type or print name

Title ________________________________

Date ________________________________

Tax ID or S.S. No. ________________________________
The completion of the signature blanks is self-explanatory. Some states require recorded documents to be attested or witnessed; and, in this event, the ATTEST OR WITNESS signature blanks should be signed. Finally, to comply with Internal Revenue Service regulations the parties should include their Tax ID or Social Security Number.
ACKNOWLEDGMENTS

Note: The following forms of acknowledgment are the short forms approved by the Uniform Law on Notarial Acts. The validity and effect of these forms in any state will depend upon the statutes of that state.

Individual acknowledgement:

State of ______________ )
) ss.
County of ______________ )

This instrument was acknowledged before me on ________________________________ by ________________________________.

(Seal, if any) ____________________________________

Title (and Rank) ________________________________

My commission expires: ________________________________

Acknowledgment in representative capacity:

State of ______________ )
) ss.
County of ______________ )

This instrument was acknowledged before me on ________________________________ by ________________________________ as ____________________________ of ________________________________.

(Seal, if any) ____________________________________

Title (and Rank) ________________________________

My commission expires: ________________________________
An acknowledgments page has been included to permit the JOA to be filed of record. Most often a Memorandum of Operating Agreement and Financing Statement will be filed of record in lieu of filing the entire JOA. By filing a Memorandum of Operating Agreement and Financing Statement, parties can keep many terms confidential, as well as saving filing and recordation fees which are generally based on the number of pages filed of record.
MEMORANDUM OF OPERATING AGREEMENT
AND FINANCING STATEMENT

On the following pages you will find a Memorandum of Operating Agreement and Financing Statement and related forms.
1.0 This Memorandum of Operating Agreement and Financing Statement (hereinafter called "Memorandum") shall be effective when the Operating Agreement referred to in Paragraph 2.0 below becomes effective, that being ____________________ 19 ____________________

2.0 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 described in Exhibit A attached hereto (hereinafter called the "Contract Area"), and designating ____________________ as Operator to conduct such operations.

3.0 The Operating Agreement provides for certain liens and/or security interests to secure payment by the parties of their respective share of costs under the Operating Agreement. The Operating Agreement contains an Accounting Procedure along with other provisions which supplement the lien and/or security interest provisions, including non-consent clauses 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.

4.0 The purpose of this Memorandum is to more fully describe and implement liens and/or security interests provided for in the Operating Agreement, and to place third parties on notice thereof.

5.0 In consideration of the mutual rights and obligations of the parties hereunder, the parties hereto agree as follows:

5.1. 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.

5.2. 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 costs.

5.3. 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 referred to in Paragraph 3.0 above. 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.

5.4. 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.

5.5. The Operator grants to Non-Operators a lien and security interest equivalent to that granted to Operator as described in Paragraph 5.3 above, to secure payment by Operator of its own share of costs when due.

6.0 For purposes of protecting said liens and security interest, the parties hereto agree that this Memorandum shall cover all right, title and interest of the debtor(s) in:

6.1 Property Subject to Security Interests

(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.

(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.

(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. Certain of the above-described items are or are to become fixtures on the Contract Area.

(J) All the proceeds and products of collateral are also covered.

6.2 Property Subject to Liens

(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.

7.0 The above items will be financed at the wellhead of the well or wells located on the Contract Area, and this Memorandum 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 Operating Agreement and all farmers and option farmers who have granted support within the Contract Area are identified on Exhibit A.

8.0 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.

[Check to ensure compliance with State Law.]

MEMORANDUM OF OPERATING AGREEMENT AND FINANCING STATEMENT

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9.0 Upon expiration of the subject Operating Agreement and the satisfaction of all debts, the Operator shall file of record a release and termination on behalf of all parties concerned. Upon the filing of such release and termination, all benefits and obligations under this Memorandum shall terminate as to all parties who have executed or ratified this Memorandum. In addition, the Operator shall have the right to file a continuation statement on behalf of all parties who have executed or ratified this Memorandum.

10.0 It is understood and agreed by the parties hereto that if any part, term, or provision of this Memorandum 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 of the parties shall be construed and enforced as if the Memorandum did not contain the particular part, term or provision held to be invalid.

11.0 This Memorandum 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 shall not in any manner affect the validity of the Memorandum as to those persons who have executed this Memorandum.

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

13.0 This Memorandum 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 with individual signature pages attached thereto needs to be filed of record.

NAME AND ADDRESS

By: ____________________________
(Signature)
Name: ____________________________
(Type or print signatory's name)
Title: ____________________________

NAME AND ADDRESS

By: ____________________________
(Signature)
Name: ____________________________
(Type or print signatory's name)
Title: ____________________________

(Insert proper state acknowledgment below)
EXHIBIT A TO MEMORANDUM OF OPERATING AGREEMENT AND FINANCING STATEMENT

CONTRACT AREA: ________________________

RECORD TITLE OWNERS

PARTIES TO THE OPERATING AGREEMENT: ________________________, ________________________, ________________________, ________________________, ________________________, ________________________, ________________________, ________________________.

FARMORS AND OPTION FARMORS: (1) ________________________, (2) ________________________, (3) ________________________, (4) ________________________, (5) ________________________, (6) ________________________, (7) ________________________, (8) ________________________.

FARMOUT AND OPTION FARMOUT SUMMARIES:

(1) On _______ 19___, ______ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ______ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(2) On _______ 19___, ______ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ______ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(3) On _______ 19___, ______ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ______ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(4) On _______ 19___, ______ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ______ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(5) On _______ 19___, ______ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ______ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(6) On _______ 19___, ______ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ______ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(7) On _______ 19___, ______ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ______ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(8) On _______ 19___, ______ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ______ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)
FARMORS AND OPTION FARMORS: (9) ____________________________ (10) ____________________________
(11) ____________________________ (12) ____________________________
(13) ____________________________ (14) ____________________________
(15) ____________________________ (16) ____________________________
(17) ____________________________ (18) ____________________________
(19) ____________________________

FARMOUT AND OPTION FARMOUT SUMMARIES:

(9) On ____________________________ 19 , ____________________________ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ____________________________ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(10) On ____________________________ 19 , ____________________________ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ____________________________ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(11) On ____________________________ 19 , ____________________________ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ____________________________ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(12) On ____________________________ 19 , ____________________________ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ____________________________ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(13) On ____________________________ 19 , ____________________________ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ____________________________ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(14) On ____________________________ 19 , ____________________________ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ____________________________ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(15) On ____________________________ 19 , ____________________________ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ____________________________ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(16) On ____________________________ 19 , ____________________________ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ____________________________ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(17) On ____________________________ 19 , ____________________________ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ____________________________ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)

(18) On ____________________________ 19 , ____________________________ (Farmor or Option Farmor) entered into a Farmout Agreement (or Option Farmout Agreement) entitling ____________________________ (Farmee) to an equitable interest in oil and gas and associated minerals within the Contract Area described above, with legal title to be assigned at a later date. The Farmout Contract covers the following acreage: (Describe all farmout or option farmout acreage)
INSTRUCTIONS

The Memorandum of Operating Agreement and Financing Statement (Memorandum) should be completed, executed and recorded to secure and perfect the lien (mortgage) and security interest created by the Operating Agreement. There are three advantages to utilizing such a Memorandum.

First, the filing of the Memorandum acts to place third parties on notice of the Operating Agreement, thereby eliminating the need to record the entire lengthy Operating Agreement.

Second, the Memorandum also acts as a lien (mortgage) and a financing statement which, once properly recorded, secures and perfects the lien and security interest in the leasehold, hydrocarbons, equipment, etc. The Memorandum can be used by the Operator to secure the debts of Non-Operators or by a Non-Operator to secure the debts of the Operator and/or other Non-Operators. The securing and perfection of this type of lien and security interest gives the secured party priority over certain other creditors should any of the Non-Operators or the Operator become bankrupt.

Third, by putting third parties on notice of a farmout or option farmout, a party may protect themselves from having a farmout or an option farmout invalidated by a bankruptcy court as an executory contract.

The instructions for the proper completion and handling of the Memorandum are discussed below.

1. **Proper Form of the Memorandum and Other Related Documents:** State law varies with regard to the form of a lien or security interest and documents relating thereto. To accommodate these variations, separate forms of the Memorandum and related documents have been prepared. The model form should be used unless a specific form has been prepared.

2. **Dating the Memorandum** (Blank One): Insert the effective date of the Operating Agreement.

3. **Designating the Operator** (Blank Two): Insert the name of the designated Operator.

4. **Preparing Exhibit A:** Exhibit A is referenced in the Memorandum and must be attached thereto. A form of Exhibit A has been prepared for your convenience. The form of Exhibit A is self-explanatory and should be completed and attached to the Memorandum. Exhibit A must contain a legal description of the Contract Area. It is advisable to also include in the Exhibit A the names of the record title owners and a summary of the farmouts and option farmouts that have been acquired. The Parties' addresses should be included on Exhibit A, if they are not provided above the signature line in the Memorandum.
5. **Distributing the Agreement for Execution**: If you are Operator, send a copy of the completed and executed Memorandum to the Non-Operators along with the Operating Agreement for the Non-Operators' execution.

   If you are a Non-Operator, either request the Operator to disseminate the Memorandum to all Non-Operators for execution along with the Operating Agreement or, if the Operator refuses to cooperate, disseminate the Memorandum to other Non-Operators directly.

6. **Verifying that all parties properly executed the Memorandum**: Confirm that each party executed and acknowledged the Memorandum and complied with any special requirements of state law. In the event that all parties did not sign the Memorandum, the Memorandum should still be filed of record. The Memorandum is intended to be effective and binding on all executing parties.

7. **Filing the Memorandum of Record**: In most states, this normally requires filing the Memorandum in the county records to secure the lien and filing the Memorandum in the office of the Secretary of State to perfect the security interest. See "Place of Filing: Exhibit to Instructions" for proper filing locations.

8. **Ratification**: If the well successfully finds hydrocarbons and at payout the farmor converts its overriding royalty interest to a working interest, the farmor should ratify the Memorandum or execute a new Memorandum and file such ratification or new Memorandum of record. A form of ratification has been prepared.

9. **Filing Continuation Statements***: The effectiveness of the Memorandum to perfect a security interest will terminate five years after the filing date unless a Continuation Statement is filed six months before the end of the five year term.

   Complete the form of Continuation Statement provided, indicating the file numbers of the original Memorandum and any subsequent Continuation Statement, the date the Continuation Statement will become effective, and circulate the Continuation Statement for execution by the parties to the Memorandum.

   File the Continuation Statement in the same office (generally the Secretary of State's office) where the Memorandum has been filed. It is not necessary to record a Continuation Statement to perpetuate the lien (mortgage), therefore, the Continuation Statement should not be recorded in the county records.

10. **Filing a Release of the Memorandum**: When the Operating Agreement expires and all debts have been satisfied, a Release should be recorded in those places where the Memorandum has been recorded. This is good business practice. A form of Release has been prepared.

   * Not applicable in Louisiana.
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.

NAME AND ADDRESS

By: ________________________________
(Signature)
Name: ________________________________
(Type or print signatory's name)
Title: ________________________________

NAME AND ADDRESS

By: ________________________________
(Signature)
Name: ________________________________
(Type or print signatory's name)
Title: ________________________________

NAME AND ADDRESS

By: ________________________________
(Signature)
Name: ________________________________
(Type or print signatory's name)
Title: ________________________________
RELEASE OF MEMORANDUM OF OPERATING AGREEMENT 
AND TERMINATION OF FINANCING STATEMENT

The undersigned, ___________________________ (Name, Address, State of Incorporation)

_________________________ (Name, Address, State of Incorporation),
hereby certifies that the Memorandum of Operating Agreement and Financing Statement dated ________________, 19___, executed by ________________, as Operator, and

_________________________ (Name, Address, State of Incorporation),
as Non-Operator(s), and recorded ______________________, 19_________, in the office of the ________________________________, County of ________________________________, State of ________, in Book __________, Page __________, and recorded in the Uniform Commercial Code records of the State of ________________________________, File No. __________, empowers the Operator to sign a Release and Termination Statement upon expiration of the subject Operating Agreement, to be binding on all parties to the Operating Agreement; and

By virtue of this authority, the undersigned hereby certifies that the subject Operating Agreement has expired and that the Memorandum of Operating Agreement and Financing Statement is hereby fully released and discharged and that the parties to the Operating Agreement no longer claim any security interest under the above mentioned Financing Statement.

IN WITNESS WHEREOF, this Release of Memorandum of Operating Agreement and Termination of Financing Statement is executed as of the ____ day of ________________, 19___.

NAME AND ADDRESS

By: ____________________________
(Signature)

Name: ____________________________
(Type or print signatory's name)

Title: ____________________________
(Acknowledgment)
RATIFICATION OF
MEMORANDUM OF OPERATING AGREEMENT AND FINANCING STATEMENT

WHEREAS the undersigned hereby acknowledges receipt of an agreement entitled "Memorandum of Operating Agreement and Financing Statement" (hereinafter Memorandum);

WHEREAS the Memorandum provides for liens and security interests in lands and leases (hereinafter Contract Area), and in tangible and intangible personal property related to the development of such Contract Area;

WHEREAS the Contract Area is located in _______________________________

____________________________________ County, State of __________
(described in detail in the Memorandum Exhibit A);

WHEREAS such Memorandum, effective _______________ 19____, is recorded in Book __________, Page __________, (Entry ______) of the records of such County, and in the UCC records, file no. ______ of such State;

AND WHEREAS the parties to the Memorandum agree therein that a person having an interest in the Contract Area can ratify such Memorandum by executing and delivering an instrument of ratification;

NOW THEREFORE, the undersigned, who has an interest in the Contract Area, in consideration of the mutual covenants contained in the Memorandum, does hereby fully ratify, adopt and enter into the Memorandum.

This ratification shall be filed in the real property records of the County, and the UCC records of the State, where the Memorandum is filed, thereby providing notice of the mutual liens and security interests now held by the parties to the Memorandum, including the undersigned.

Effective Date of Ratification ________________________.

NAME AND ADDRESS

By: ________________________________
(Signature)

Name: ________________________________
(Type or print signatory's name)

Title: ________________________________

(Acknowledgment)

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MODEL FORM RECORDING SUPPLEMENT TO
OPERATING AGREEMENT AND FINANCING STATEMENT

THIS AGREEMENT, entered into by and between

hereinafter referred to as "Operator", and the signatory party or parties other than Operator, hereinafter referred to
individually as "Non-Operator", and collectively as "Non-Operators".

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" (said land, Leases and Interests being hereinafter called the "Contract Area"), and in any instance in
which the Leases or Interests of a party are not of record, the record owner and the party hereof that owns the interest or
rights therein are reflected on Exhibit "A";

WHEREAS, the parties hereto have executed an Operating Agreement dated
(herein the "Operating Agreement"), covering the Contract Area for the purpose of exploring and developing such lands,
Leases and Interests for Oil and Gas; and

WHEREAS, the parties hereto have executed this agreement for the purpose of imparting notice to all persons of the
rights and obligations of the parties under the Operating Agreement and for the further purpose of perfecting those rights
capable of perfection.

NOW, THEREFORE, in consideration of the mutual rights and obligations of the parties hereto, it is agreed as follows:

1. This agreement supplements the Operating Agreement, which Agreement in its entirety is incorporated herein by
reference, and all terms used herein shall have the meaning ascribed to them in the Operating Agreement.

2. The parties do hereby agree that:
   A. The Oil and Gas Leases and/or Oil and Gas Interests of the parties comprising the Contract Area shall be subject
to and burdened with the terms and provisions of this agreement and the Operating Agreement, and the parties do
hereby commit such Leases and Interests to the performance thereof.
   B. The exploration and development of the Contract Area for Oil and Gas shall be governed by the terms and
provisions of the Operating Agreement, as supplemented by this agreement.
   C. All costs and liabilities incurred in operations under this agreement and the Operating Agreement shall be borne
paid, and all equipment and materials acquired in operations on the Contract Area shall be owned, by the parties
hereof, as provided in the Operating Agreement.
   D. Regardless of the record title ownership to the Oil and Gas Leases and/or Oil and Gas Interests identified on
Exhibit "A", all production of Oil and Gas from the Contract Area shall be owned by the parties as provided in the
Operating Agreement; provided nothing contained in this agreement shall be deemed an assignment or cross-assignment
of interests covered hereby.
   E. Each party shall pay or deliver, or cause to be paid or delivered, all burdens on its share of the production from the
Contract Area as provided in the Operating Agreement.
   F. An overriding royalty, production payment, net profits interest or other burden payable out of production hereafter
created, assignments of production given as security for the payment of money and those overriding royalties, production
payments and other burdens payable out of production heretofore created and defined as Subsequently Created Interests
in the Operating Agreement shall be (i) borne solely by the party whose interest is burdened therewith, (ii) subject to
suspension if a party is required to assign or relinquish to another party an interest which is subject to such burden, and
(iii) subject to the lien and security interest hereinafter provided if the party subject to such burden fails to pay its share
of expenses chargeable hereunder and under the Operating Agreement, all upon the terms and provisions and in the
times and manner provided by the Operating Agreement.
   G. The Oil and Gas Leases and/or Oil and Gas Interests which are subject hereto may not be assigned or transferred
except in accordance with those terms, provisions and restrictions in the Operating Agreement regulating such transfers.
This agreement and the Operating Agreement shall be binding upon and shall inure to the benefit of the parties hereto,
and their respective heirs, devisees, legal representatives, and assigns, and the terms hereof shall be deemed to run with
the leases or interests included within the lease Contract Area.
   H. The parties shall have the right to acquire an interest in renewal, extension and replacement leases, leases
proposed to be surrendered, wells proposed to be abandoned, and interests to be relinquished as a result of non-
participation in subsequent operations, all in accordance with the terms and provisions of the Operating Agreement.
   I. The rights and obligations of the parties and the adjustment of interests among them in the event of a failure or
loss of title, each party's right to propose operations, obligations with respect to participation in operations on the
Contract Area and the consequences of a failure to participate in operations, the rights and obligations of the parties
regarding the marketing of production, and the rights and remedies of the parties for failure to comply with financial
obligations shall be as provided in the Operating Agreement.
   J. Each party's interest under this agreement and under the Operating Agreement shall be subject to relinquishment
for its failure to participate in subsequent operations and each party's share of production and costs shall be reallocated
on the basis of such relinquishment, all upon the terms and provisions provided in the Operating Agreement.
   K. All other matters with respect to exploration and development of the Contract Area and the ownership and
transfer of the Oil and Gas Leases and/or Oil and Gas Interests therein shall be governed by the terms and provisions of
the Operating Agreement.

3. The parties hereby grant reciprocal liens and security interests as follows:
   A. Each party grants to the other parties hereto a lien upon any interest it now owns or hereafter acquires in Oil and
Gas Leases and Oil and Gas Interests in the Contract Area, and a security interest and/or purchase money security
interest in any interest it now owns or hereafter acquires in the personal property and fixtures on or used or obtained
for use in connection therewith, to secure performance of all of its obligations under this agreement and the Operating
Agreement including but not limited to payment of expense, interest and fees, the proper disbursement of all monies
paid under this agreement and the Operating Agreement, the assignment or relinquishment of interest in Oil and Gas
Leases as required under this agreement and the Operating Agreement, and the proper performance of operations under
this agreement and the Operating Agreement. Such lien and security interest granted by each party hereto shall include
such party's leasehold interests, working interests, operating rights, and royalty and overriding royalty interests in the
Contract Area now owned or hereafter acquired and in lands pooled or unitized therewith or otherwise becoming subject
to this agreement and the Operating Agreement, the Oil and Gas when extracted therefrom and equipment situated
thereon or used or obtained for use in connection therewith (including, without limitation, all wells, tools, and tubular
goods), and accounts (including, without limitation, accounts arising from the sale of production at the wellhead),

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contract rights, inventory and general intangibles relating thereto or arising therefrom, and all proceeds and products of
the foregoing.
B. Each party represents and warrants to the other parties hereto that the lien and security interest granted by such
party to the other parties shall be a first and prior lien, and each party hereby agrees to maintain the priority of said lien
and security interest against all persons acquiring an interest in Oil and Gas Leases and Interests covered by this
agreement and the Operating Agreement by, through or under such party. All parties acquiring an interest in Oil and
Gas Leases and Oil and Gas Interests covered by this agreement and the Operating Agreement, whether by assignment,
merger, mortgage, operation of law, or otherwise, shall be deemed to have taken subject to the lien and security interest
granted by the Operating Agreement and this instrument as to all obligations attributable to such interest under this
agreement and the Operating Agreement whether or not such obligations arise before or after such interest is acquired.
C. To the extent that the parties have a security interest under the Uniform Commercial Code of the state in which
the Contract Area is situated, they 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 a party for the secured indebtedness shall not be deemed an
election of remedies or otherwise affect the lien rights or security interest as security for the payment thereof. In
addition, upon default by any party in the payment of its share of expenses, interest or fees, or upon the improper use of
funds by the Operator, the other parties shall have the right, without prejudice to other rights or remedies, to collect
from the purchaser the proceeds from the sale of such defaulting party's share of Oil and Gas until the amount owed by
such party, plus interest, has been received, and shall have the right to offset the amount owed against the proceeds from
the sale of such defaulting party's share of Oil and Gas. All purchasers of production may rely on a notification of default
from the non-defaulting party or parties stating the amount due as a result of the default, and all parties waive any
recourse available against purchasers for releasing production proceeds as provided in this paragraph.
D. If any party fails to pay its share of expense within one hundred-twenty (120) days after rendition of a statement
therefor by Operator the non-defaulting parties, including Operator, shall, upon request by Operator, pay the unpaid
amount in the proportion that the interest of each such party bears to the interest of all such parties. The amount paid
by each party so paying its share of the unpaid amount shall be secured by the liens and security rights described in this
paragraph 3 and in the Operating Agreement, and each paying party may independently pursue any remedy available
under the Operating Agreement or otherwise.
E. If any party does not perform all of its obligations under this agreement or the Operating Agreement, and the
failure to perform subjects such party to foreclosure or execution proceedings pursuant to the provisions of this
agreement or the Operating Agreement, to the extent allowed by governing law, the defaulting party waives any
available right of redemption from and after the date of judgment, any required valuation or appraisement of the
mortgaged or secured property prior to sale, any available right to stay execution or to require a marshalling of assets
and any required bond in the event a receiver is appointed. In addition, to the extent permitted by applicable law, each
party hereby grants to the other parties a power of sale as to any property that is subject to the lien and security rights
granted hereunder or under the Operating Agreement, such power to be executed in the manner provided by applicable
law or otherwise in a commercially reasonable manner and upon reasonable notice.
F. The lien and security interest granted by this paragraph 3 supplements identical rights granted under the
Operating Agreement.
G. To the extent permitted by applicable law, Non-Operators agree that Operator may invoke or utilize the
mechanics' or materialmen's lien law of the state in which the Contract Area is situated in order to secure the payment
to Operator of any sum due under this agreement and the Operating Agreement for services performed or materials
supplied by Operator.
H. The above described security will be financed at the wellhead of the well or wells located on the Contract Area and
this Recording Supplement may be filed in the land records in the County or Parish in which the Contract Area is
located, and as a financing statement in all recording offices required under the Uniform Commercial Code or other
applicable state statutes to perfect the above-described security interest, and any party hereto may file a continuation
statement as necessary under the Uniform Commercial Code, or other state laws.
4. This agreement shall be effective as of the date of the Operating Agreement as above recited. Upon termination of
this agreement and the Operating Agreement the satisfaction of all obligations thereunder, Operator is authorized to file
record in all necessary recording offices a notice of termination, and each party hereto agrees to execute such a notice of
termination as to Operator, upon the request of Operator, if Operator has complied with all of its financial
obligations.
5. This agreement and the Operating Agreement shall be binding upon and shall inure to the benefit of the parties
hereto and their respective heirs, devisees, legal representatives, successors and assigns. No sale, encumbrance, transfer or
other disposition shall be made by any party of any interest in the Leases or Interests subject hereto except as expressly
permitted under the Operating Agreement and, if permitted, shall be made expressly subject to this agreement and the
Operating Agreement and without prejudice to the rights of the other parties. If the transfer is permitted, the assignee of an
ownership interest in any Oil and Gas Lease shall be deemed a party to this agreement and the Operating Agreement as to
the interest assigned from and after the effective date of the transfer of ownership; provided, however, that the other parties
shall not be required to recognize any such sale, encumbrance, transfer or other disposition for any purpose hereunder until
thirty (30) days after they have received a copy of the instrument of transfer or other satisfactory evidence thereof in writing
from the transferor or transferee. No assignment or other disposition of interest by a party shall relieve such party of
obligations previously incurred by such party under this agreement or the Operating Agreement with respect to the interest
transferred, including without limitation the obligation of a party to pay all costs attributable to an operation conducted under
this agreement and the Operating Agreement in which such party has agreed to participate prior to making such assignment,
and the lien and security interest granted by Article VII.B. of the Operating Agreement and hereby shall continue to burden
the interest transferred to secure payment of any such obligations.
6. In the event of a conflict between the terms and provisions of this agreement and the terms and provisions of the
Operating Agreement, then, as between the parties, the terms and provisions of the Operating Agreement shall control.
7. This agreement shall be binding upon each Non-Operator when this agreement or a counterpart thereof has been
executed by such Non-Operator and Operator notwithstanding that this agreement is not then or thereafter executed by all of
the parties to which it is tendered or which are listed on Exhibit "A" as owning an interest in the Contract Area or which
own, in fact, an interest in the Contract Area. In the event that any provision herein is illegal or unenforceable, the
remaining provisions shall not be affected, and shall be enforced as if the illegal or unenforceable provision did not appear herein.
8. Other provisions.

IN WITNESS WHEREOF, this agreement shall be effective as of the ____ day of ________________, 19______.

ATTEST OR WITNESS: OPERATOR

______________________________
By: ____________________________
Title: __________________________
Date: __________________________
Address: _________________________

ATTEST OR WITNESS: NON-OPERATORS

______________________________
By: ____________________________
Title: __________________________
Date: __________________________
Address: _________________________

ATTEST OR WITNESS:

______________________________
By: ____________________________
Title: __________________________
Date: __________________________
Address: _________________________

ATTEST OR WITNESS:

______________________________
By: ____________________________
Title: __________________________
Date: __________________________
Address: _________________________

ATTEST OR WITNESS:

______________________________
By: ____________________________
Title: __________________________
Date: __________________________
Address: _________________________
Acknowledgments

Note:

The following forms of acknowledgment are the short forms approved by the Uniform Law on Notarial Acts. The validity and effect of these forms in any state will depend upon the statutes of the state.

Individual Acknowledgment

STATE OF __________________ §
§ ss
COUNTY OF __________________ §

This instrument was acknowledged before me on ____________________________,
by ____________________________.

(Seal, if any)

Title (and Rank) ____________________________
My Commission Expires: ____________________________

Acknowledgment in Representative Capacity

STATE OF __________________ §
§ ss
COUNTY OF __________________ §

This instrument was acknowledged before me on ____________________________,
by ____________________________ as ____________________________ of

(Seal, if any)

Title (and Rank) ____________________________
My Commission Expires: ____________________________
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

<table>
<thead>
<tr>
<th>Name and Address</th>
<th>Percentage Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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

<table>
<thead>
<tr>
<th>Parties</th>
<th>Net Surface Acres Committed</th>
<th>Percentage Working Interest in Contract Area %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Totals

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, County .

A. Leases committed by ______________________________ (100%):

<table>
<thead>
<tr>
<th>LESSOR</th>
<th>LESSEE</th>
<th>LEASE DATE</th>
<th>LEASE EXPIRATION</th>
<th>NET SURFACE ACRES COMMITTED</th>
<th>LESSOR ROYALTY</th>
<th>OTHER BURDENS</th>
<th>RECORDING REFERENCES BOOK PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

B. Leases committed by ______________________________ (100%):

<table>
<thead>
<tr>
<th>LESSOR</th>
<th>LESSEE</th>
<th>LEASE DATE</th>
<th>LEASE EXPIRATION</th>
<th>NET SURFACE ACRES COMMITTED</th>
<th>LESSOR ROYALTY</th>
<th>OTHER BURDENS</th>
<th>RECORDING REFERENCES BOOK PAGE</th>
</tr>
</thead>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

C. Leases committed by ___________( %), ___________( %), and _______________ ( %) in the respective proportions indicated:

<table>
<thead>
<tr>
<th>LESSOR</th>
<th>LESSEE</th>
<th>LEASE DATE</th>
<th>LEASE EXPIRATION</th>
<th>NET SURFACE ACRES COMMITTED</th>
<th>LESSOR ROYALTY</th>
<th>OTHER BURDENS</th>
<th>RECORDING REFERENCES BOOK PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

D. ______________________ (100%) commits an _______________________________ unleased, undivided (Insert Fraction) mineral interests in (description of acreage), being _________ total net mineral acres unleased.

<table>
<thead>
<tr>
<th>GRANTOR</th>
<th>GRANTEE</th>
<th>DEED DATE</th>
<th>BURDENS</th>
<th>ON PRODUCTION</th>
<th>RECORDING REFERENCE BOOK PAGE</th>
</tr>
</thead>
</table>
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 _______.

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

<table>
<thead>
<tr>
<th>LESSOR</th>
<th>LESSEE</th>
<th>LEASE DATE</th>
<th>LEASE EXPIRATION</th>
<th>NET SURFACE ACRES COMMITTED</th>
<th>LESSOR ROYALTY</th>
<th>OTHER BURDENS</th>
<th>RECORDING REFERENCES</th>
</tr>
</thead>
</table>

2. Leases committed by _____________(100%):

<table>
<thead>
<tr>
<th>LESSOR</th>
<th>LESSEE</th>
<th>LEASE DATE</th>
<th>LEASE EXPIRATION</th>
<th>NET SURFACE ACRES COMMITTED</th>
<th>LESSOR ROYALTY</th>
<th>OTHER BURDENS</th>
<th>RECORDING REFERENCES</th>
</tr>
</thead>
</table>

3. Leases committed by _____________( %), _____________( %), and _____________( %) in the respective proportions indicated:

<table>
<thead>
<tr>
<th>LESSOR</th>
<th>LESSEE</th>
<th>LEASE DATE</th>
<th>LEASE EXPIRATION</th>
<th>NET SURFACE ACRES COMMITTED</th>
<th>LESSOR ROYALTY</th>
<th>OTHER BURDENS</th>
<th>RECORDING REFERENCES</th>
</tr>
</thead>
</table>

C. Percentage Working Interests of the Parties

| Parties | Net Acres Committed | Contract Area Prior to Farmouts | Initial (or Substitute) Well and its Proration Unit Prior to Payout | Proration Unit for Initial Well (or its Substitute) after Payout* and the Remainder of the Contract Area |
|---------|---------------------|---------------------------------|---------------------------------|-----------------|-----------------|

* 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
in the county of __________, State of __________, containing __________ 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 non-hydrocarbon substances produced in association therewith.

The term "gas" as used herein includes helium, carbon dioxide and other commercially valuable gases, as well as hydrocarbon gases. In addition to the above-described lands, this lease and the term "leased premises" also covers acreages and any small strips or parcels of land now or hereafter owned by Lessor which are contiguous or adjacent to the above-described land, 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 so 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 Lessor's separator facilities, the royalty shall be one-eighth of such production, to be determined by the average density or ratio of 100,000 cubic feet or more per barrel, based on a 24-hour production test conducted under normal producing conditions using standard lease separator facilities or equivalent testing equipment, and the term "horizontal completion" means an oil well in which the horizontal component of the gross completion interval in the reservoir exceeds the vertical component thereof. 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 or lands pooled therewith, no shut-in royalty shall be due until the end of the 90-day period next following cessation of such operations or production. 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 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.

If Lessee fails to properly pay shut-in royalty or other royalty payments when due under this lease, Lessor may terminate this lease by giving notice to Lessee at any time after the end of the 90-day period next following cessation of such operations or production. 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.
7. Proportionate Reduction. 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 duly authenticated copies of the documents establishing such change of ownership to the satisfaction of Lessee or until Lessee 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 less than all of the interest or 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 covered hereby on the leased premises, except water from Lessor's wells or ponds. In exploring, developing, producing or marketing from the leased premises or lands pooled or unitized therewith, the ancillary rights granted herein shall apply (a) to the entire leased premises described in Paragraph 1 above, notwithstanding any partial release or other partial termination of this lease, and (b) to any other lands in which Lessor now or hereafter has authority to grant such rights in the vicinity of the leased premises of lands pooled therewith. When requested by Lessee 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 or other lands of Lessor used by Lessee hereunder, without Lessor's consent, and Lessee shall pay for damage caused by its operations to buildings and other improvements now on the leased premises or such other lands, 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 or such other lands 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 regulation of the price or transportation of oil, gas and other substances covered hereby. When drilling, 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 Lessor'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 or delayed as to be interrupted.

12. Breach or Default. No litigation shall be initiated by Lessee with respect to any breach or default by Lessee hereunder, for a period of at least 90 days after Lessee 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. Lessee 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 Lessor is made aware of any claim inconsistent with Lessee'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.
EXHIBIT "C"
TO OPERATING AGREEMENT

ACCOUNT PROCEDURE

JOINT OPERATIONS
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.

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Section I. General Provisions

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-Operators advance their estimated cash outlays for the succeeding month's operation within 15 days after receipt of the billing or by the first day of the month for which the advance is required, whichever is later. Although Non-Operators are contractually given in certain circumstances only 15 days to advance payment, this requirement is often not met. For many of the larger companies, the interval payment processes may not be able to pay invoices within 15 days of invoice.

Cash advances are customarily requested in the face of major expenditures. For example, advances are usually required when developing large on-shore units. Small Operators who cannot easily fund on-going operations, will often make use of the advance provision.

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 most 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. Having said this, interest is not commonly imposed or demanded.

Section I.4.

Non-Operators have 24 months from the end of the calendar year in which a bill or statement has been submitted to audit and make claims on the Operator for any exceptions to such bill or statement. The failure to raise an objection or exception within such 24-month limitation period, is construed as a deemed acceptance of the accuracy and correctness of a bill or statement. Although the language does not mandate any level of specificity, the claim or exception should be specific enough to clearly identify the areas challenged.
5. Audits
   A. A Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct a joint audit in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator. The audits shall not be conducted more than once each year without prior approval of Operator, except upon the resignation or removal of the Operator, and shall be made at the expense of those Non-Operators approving such audit.

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

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

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

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

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

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

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

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

6. Transportation
   Transportation of employees and Material necessary for the Joint Operations but subject to the following limitations:
   A. If Material is moved to the Joint Property from the 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 encourages Non-Operators to conduct joint audits. Audits must be conducted within 24 months following the end of a calendar year. 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. Unfortunately, no penalty is imposed for failure to meet the 180 day reply period.

Section I.6.

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

Section II. Direct Charges

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. In light of society's increasing emphasis on environmental issues, this statement will likely take on greater importance.

Section II.2.

This provision recognizes that in many situations the Operator will pay all or a portion of the rentals and royalties owned by Non-Operators and that such charges are to be made 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. In summary, salaries and wages (benefits) of field employees directly employed on the Joint Property, First Level Supervisors; and Technical Employees directly employed on the Joint Property, if such charges are excluded from the overhead rates, are chargeable to the Joint Account. The term "directly employed on the Joint Property" is not defined. It is generally viewed, however, that for a labor joint interest charge to be valid it must relate to activities physically performed by the individual on the site of the Joint Property.
5. Audits

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

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

6. Approval By Non-Operators

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

II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

1. Ecological and Environmental

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

2. Rentals and Royalties

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

3. Labor

A. (1) Salaries and wages of Operator's field employees directly employed on the Joint Property in the conduct of Joint Operations.

   (2) Salaries of First Level Supervisors in the field.

   (3) Salaries and wages of Technical Employees directly employed on the Joint Property if such charges are excluded from the overhead rates.

   (4) Salaries and wages of Technical Employees either temporarily or permanently assigned to and directly employed in the operation of the Joint Property if such charges are excluded from the overhead rates.

B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 3A of this Section II. Such costs under this Paragraph 3B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 3A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.

C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 3A and 3B of this Section II.

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

4. Employee Benefits

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

5. Material

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

6. Transportation

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

A. If Material is moved to the Joint Property from the 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 II.4.

Most companies utilize the recommended COPAS benefit percentage. To this percentage burdens are added, such as Social Security and Worker's Compensation, or Employer's Liability insurance.

Section II.5.

Although the accumulation of surplus stock is to be avoided, there is no penalty for the failure to comply with this mandate. A Non-Operator could allege that such accumulation of surplus stock violates the standard of a reasonably prudent Operator. This could, although extremely unlikely, result in the removal of an Operator. A Non-Operator might claim it should pay a discounted price of the accumulated surplus stock to compensate it for its loss of the time value of money. Any such amount would have to be adjusted to reflect reasonable projected cost increases. Due to the complexity of these calculations, all a Non-Operator can reasonably expect to accomplish is to ensure that the accumulation of surplus stock be avoided or at least kept to a minimum.
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 judgement 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. This provision has been included to provide financial disincentives for an Operator to stock materials in a distant warehouse. The Operator will only be able to recover transportation costs from the nearest supply store or railway station, if the charge exceeds $400. Relocation costs are chargeable to the Joint Account, unless the move is for the primary benefit of the Operator.

Section II.7.

Contract services for people and equipment are chargeable to the Joint Account if not part of the overhead expense.

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 8% 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%.

COPAS issued Interpretation #16 on October 22, 1986, which addressed the use of subsidiaries and related entities. In summary, Interpretation #16 concludes that related entities cannot charge for their services unless they have substantial non-related business and their prices are "no higher than the lesser of: (1) those offered by the related entity to its most favored customers, or (2) those offered to or obtained by the Operator from unrelated entities providing such services or products in the geographical area." The related entity must not merely serve as a vehicle for re-billing services or products provided by unrelated companies.

Section II.9.

The Joint Account is responsible for the cost of repair and replacement of all Joint Property damaged, unless caused by the gross negligence of the Operator. And the Operator shall promptly supply the Non-Operators with a report which discusses the loss.
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.10.

Legal expenses related to litigation, discharging liens and settlements are chargeable to the Joint Account, other legal expenses are not chargeable to the Joint Account, unless agreed to by the Parties.

Section II.11.

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." See Article VII.F. of the JOA.

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."

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. The expense of owning or leasing and operating telephones, radios, alarm and paging systems, automatic well test systems, computer production control systems, microwave systems, etc. should be allocated on an equitable basis to all properties serviced.
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. Overhead

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 Employees directly employed on the Joint Property should be charged to the Joint Account or carried as an overhead expense,

iii. the expenses of Technical Employees 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 Employees' expenses to the Joint Account; however, this decision is often subject to heated negotiations. If "onsite" and/or "offsite" Technical Employees' 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. Note that Drilling Well Rate charges cannot be made during suspensions that last more than 15 calendar days. Producing Well Rates apply whenever an active well produced or was used as an injection well for any portion of the month; each active completion in a multi-completed well in which production is not commingled; a well is shut-in because of overproduction or because the purchaser fails to take production; and a well is plugged and abandoned, where the Drilling Well Rate does not apply. Questions have arisen as to whether the monthly Producing Well Rate should apply to a well which is shut-in for an extended period of time or to a water pressure, injection well or a salt water disposal well which injects a very small amount of water or other chemical, say one gallon during a one day period during the month.
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.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 is frequently 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 the Percentage Basis in Section III.1.i. is selected. Note that legal expenses (and lease rentals and royalties) are specifically excluded from the calculation of operating costs. The blanks are usually completed with percentages which range from 8% to 15%. Development percentages typically range from 8% to 10% and operating percentages range from 10% to 15%.

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. COPAS in one of its Interpretative Sections clarifies that where a single event affects more than one jointly-owned property operated under a single contract, the overhead rates shall apply to the gross costs incurred due to this single event. Gross costs are, however, to be reduced by the value of salvage or insurance proceeds. COPAS recognizes in its Interpretative Sections directive that gross costs may include costs not specifically addressed in the Accounting Procedure; for example, clean-up costs off the Joint Property incurred as a consequence of an oil spill that occurred on the Joint Property. Under this situation the "Operator should separately identify for audit purposes the gross cost of the catastrophe, due to special accounting required and, if applicable, for insurance purposes."
(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 IV. Pricing of Joint Account Material Purchases, Transfers and Dispositions

Section IV.1.

Discounts obtained by the Operator are to be passed on to the Non-Operators. Whether appropriate discounts have been passed along is often a highly contentious issue. Operators often purchase a substantial amount of material which they warehouse. By purchasing substantial quantities they are able to obtain volume discounts. Whether the discounts are passed to Non-Operators and the level of such discounts are topics at many audit discussions.
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 ¾ 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 ¾ 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 ¾ 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.2.A.

The new Material provision was substantially modified in the 1984 COPAS. The pricing procedure now conforms to the general industrial pricing methods using Eastern mills as the basing point. General Electric has developed a computerized pricing system which is in general use.

New Material is priced at an Eastern mills published price. This concept made sense when most tubulars and pipe were manufactured in Eastern United States' mills. Under the terms of Section IV.2.A., an Operator who purchases Material from Korea at a price which is 50% less than that which is charged at Eastern mills would charge the Non-Operators 50% more for the material than he paid. This provision has been characterized by many oil and gas accountants as simply a license to steal. How does Section VI.1., which requires discounts to the shared, square with Section VI.2.?

Section IV.2.B.

The Operator can at its discretion purchase used Material. Good used Material is priced at 75% of current new price. Operators will employ equipment used at other locations or stored in its warehouse. By doing so, the Operator is able to have the Joint Account buy the Material for 75% of the then current new price. When an Operator moves Material off the Joint Property it must pay 75% of current new price for Material which was originally charged as new Material and 65% of current new price for Material which was originally charged to the Joint Account as used Material. The Accounting Procedure does not address the situation where an Operator installs good used Material, then removes the Material and, thereafter, installs the Material again. When the good used Material is removed the Joint Account is only paid 65% of current new price, but when the Operator installs the same Material he may well be paid 75% of the current new price.

Section IV.2.C.(1).

Material which requires reconditioning is priced at 50% of current new price. The cost of the Material and reconditioning must be less than 75%.
(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 IV.2.C.(2).

Material which is no longer usable for its intended purpose but which can be put to another use, is chargeable on a basis commensurate with its use.

Section IV.2.C.(3).

Junk shall be priced at its fair market value or the prevailing price.

Section IV.2.D.

Obsolete Material which is serviceable, but generally no longer used shall be priced at an amount which the Parties agree.

Section IV.2.E.

Loading and unloading is generally charged on an annually adjusted price published by COPAS.

Section IV.3.

If due to a shortage, certain Materials cannot be easily acquired, the Operator shall notify the Non-Operators of premium price that the Operator believes is necessary to acquire the Material in short supply. Within 10 days of receipt of such written notice, each Non-Operator shall have the right to furnish in kind all or a part of its share of such Material. The Material furnished by the Non-Operators must be of a quality and condition acceptable to the Operator.

Section IV.4.

The Operator does not warrant Material purchased for or transferred to the Joint Account. It is, however, the Operator's responsibility and obligation to ensure that all manufacturer or distributor warranties are pursued and credits and settlements are passed on to the Non-Operators.
(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. Inventories

Section V.1.

Inventories are to be taken at "reasonable intervals." Some Operators only conduct an initial inventory while others conduct periodic inventories on an annual or decade basis. Industry has been unable to agree on how frequently inventories should be conducted and, consequently, the standard is not specific. Operators must give Non-Operators at least 30 days written notice before an inventory can be conducted, so as to give Non-Operators the ability to be present when the inventory is taken. The failure of a Non-Operator to be represented at the inventory shall bind the Non-Operator to the Operator's inventory determination.

Section V.2.

Section V.2. was amended in 1984 to compel the Operator to make inventory adjustments within 6 months of the inventory. The Operator is only liable for shortages if the shortages are caused by a lack of reasonable care. Interestingly, the Operator charges the Joint Account for any overages, but with the exception of a lack of reasonable diligence, it makes no monetary adjustment on shortages to the Joint Account.

Section V.3.

Special inventories may be taken in the event of any sale, change of interest or change of Operator. It is rare that a special inventory is conducted.

Section V.4.

The expense of conducting periodic inventories is not chargeable to the Joint Account unless agreed to by the Parties. Special inventories are paid by those requesting such inventories, except that the Joint Account will pay for special inventories taken due to a change of Operator.
EXHIBIT "D"

TO OPERATING AGREEMENT

INSURANCE

On the following pages you will find two Insurance forms.
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.
At all times while operations are conducted hereunder, Operator shall comply with the workers compensation law of the state where operations are being conducted; provided, however, that Operator may be a self-insurer for liability under such compensation laws in which event the only charge that shall be made to the joint account shall be as provided in the COPAS. Operator shall also carry or provide insurance for the benefit of the joint account of the parties employer's liability insurance covering each employee engaged in operations hereunder in at least the amount of $___________ and such other insurance as outlined in the provisions below which are selected by the parties:

Check applicable provisions:

- [ ] Automobile bodily injury liability insurance in the amount of $___________ each person, $___________ each occurrence.
- [ ] Automobile property damage liability in the amount of $___________ per occurrence.
- [ ] General liability insurance in the amount of $___________ per occurrence including all operations, independent contractors, completed operations, and blanket contractual liability (including oral contracts).
- [ ] Broad form property damage liability insurance in the amount of $___________ per occurrence, including all operations, independent contractors, completed operations, and blanket contractual liability (including oral contracts).
- [ ] Umbrella liability insurance in the amount of $___________ covering liability of the parties for loss or damage exceeding the insurance coverage specified above or otherwise not covered by insurance maintained by Operator or any third-party contractor.
- [ ] Control of well insurance in the amount of $___________ for each occurrence including expense for clean-up, containment, seepage and pollution; coverage for this insurance shall be subject to a deductible of $___________.

Deletion of the following exclusions from liability insurance (check those to be deleted):

- [ ] Blowout and cratering
- [ ] Blasting
- [ ] Natural resources -- water pollution
- [ ] Saline substances

Insurance for the protection of the jointly owned equipment in the Contract Area against fire, windstorm, tornado, explosion, vandalism, malicious mischief or other extended perils.

- [ ] Other

Operator shall require all contractors engaged in work on or for the Contract Area to comply with the workers compensation law of the state where the operations are being conducted and to maintain appropriate employer's liability insurance and such other insurance as Operator may require, including at a minimum the insurance selected below:

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<th>Coverage</th>
<th>Minimum Limits</th>
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<td>Drilling</td>
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<td>Contractors</td>
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<td>Contractors</td>
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<td>Workers Compensation</td>
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<td><strong>General Liability</strong></td>
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<td>Each Occurrence</td>
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<td>Property Damage</td>
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<td>Contractor's Equipment</td>
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<td>Actual cash value, or per rental or lease contract, as appropriate.</td>
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In the event automobile liability insurance is specified above, or subsequently receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for such insurance for Operator's automotive equipment.

Each party shall be responsible for maintaining its own insurance in excess of the amounts or coverages specifically selected above, and unless provided otherwise above each party shall be responsible for insuring its own interest in the Contract Area with respect to physical damage to property, theft or loss of income.

Each insurance policy obtained by Operator with respect to operations conducted hereunder shall name the Non-Operators as additional insureds and shall contain a waiver of subrogation with respect to the Non-Operators.

Upon request, Operator shall cause a certificate of the insurance obtained hereunder for the joint account to be delivered to Non-Operators. Such certificate shall describe the coverage obtained, any exclusions from such coverage, and the parties insured thereunder, and shall provide at least thirty (30) days prior notice to Non-Operators in the event of cancellation.
INSURANCE

Most JOAs contain short, one page Insurance Exhibits which specify the types of insurance the Operator is required to obtain and the individual insurance amounts. An example of such a form is included.

The Insurance Exhibit is usually not a contentious issue. Three interrelated issues do, however, arise. Can a party self-insure? And if the Operator self-insures, what insurance premiums should the Operator pass on to the Non-Operators? How should deductibles be handled?

Some companies self-insure and they do not want to pay their percentage interest share of any insurance obtained by the Operator. From an Operator's perspective, it may be acceptable for a large, financially strong company to self-insure, but unacceptable for a financially weak company to self-insure. This is not a problem because the Operator itself may self-insure and the Operator may agree not to charge the objecting Non-Operator its proportionate share of the deemed fair market cost of such insurance. Operators can and often elect to provide the insurance themselves and then bill the Non-Operators their proportionate share of the deemed fair market cost of such insurance.

Technically, under Section II.12. of the COPAS, the Operator is only permitted to self-insure for "Workers Compensation and/or Employers Liability" where permitted under state law. Companies have broadly construed this provision and have on occasion self-insured all insurance coverage required whether or not it falls within this category.

If the Operator self-insures and does not bill the Non-Operators accordingly, the Operator may be forced to personally cover a liability up to the minimum insurance coverage limits at its sole cost. Conversely, it may be dangerous to sanction an Operator's decision to self-insure, where the Operator is financially weak and may be unable to cover the minimum insurance coverage limits, no less its proportionate share of such liability. Assuming the Operator is permitted to self-insure, the Non-Operators need to be vigilant in assuring themselves that the Operator has the financial strength to meet its minimum insurance coverage limits and is billing the Non-Operators fairly for the coverage provided. Section II.12 of the COPAS states that if the Operator elects to "act as a self-insurer for Worker's Compensation and/or Employers Liability under the respective State's law, Operator may 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."

Finally, how should deductibles be handled? Any deductibles maintained in the Operator's insurance program carried for the joint account should be accepted by the Non-Operators or a statement providing for the sharing of deductibles by the joint account should be included in the JOA. Failing this, a Non-Operator may receive a bill for its proportionate share of a deductible which the Non-Operator believed was fully covered.

The drafting committee offered a more extensive insurance provision which has
been included. Note that this provision also addresses insurance to be obtained by contractors. The Operator is required to ensure that contractors obtain certain insurance at specified levels. Finally, if requested, the Operator is to furnish the Non-Operators with a certificate of insurance which describes the coverage, exclusions, parties insured and the cancellation notice period.
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.

Gas imbalances occur as a consequence of one or more of a myriad of causes. Gas imbalances are most commonly, a result of "split stream sales." Split stream sales occur when one or more of the working interest owners sells its gas to different purchasers and the purchasers fail to take the working interest owners exact entitlement. Gas imbalances also can, for example, occur where due to contractual arrangements purchasers are not required to take a specified volume during any period or due to quality specifications and/or line pressure limitations, pipelines and/or purchasers do not have to take the gas. Moreover, imbalances can also occur as a consequence of the timing of negotiations on new or renewal contracts to sell or transport gas. Likewise, FERC proceedings may not affect all working interest owners equally and the resulting delay may cause an imbalance. Finally, individual working interest owners may temporarily elect not to sell their gas until the gas price increases or until they can obtain economic transportation.

Frequently, those that object to the incorporation of a Gas Balancing Agreement will argue that Option No. 2 in the 1989 Form or page 8 alternate in the 1982 Form circumvent the necessity of a Gas Balancing Agreement. These provisions do no more than give the Operator the right to purchase or sell a Non-Operator's gas upon 30 days notice. Option No. 1 in the 1989 Form and page 8 in the 1982 Form assume that the parties have incorporated a Gas Balancing Agreement and do not give the Operator the right to purchase or sell the Non-Operator's gas. Option No. 2 in the 1989 Form and page 8 alternate establishes only a symmetry between oil and gas, which does not exist if they are not used. Option No. 2 of the 1989 Form and page 8 alternate are simply not substitutes 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. Gas today is sold on short term "spot" sales and under larger term contracts. 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.

David 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. 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-Operators' gas in excess of one year risk being characterized by the Internal Revenue Service 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 wellbore. 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. And 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 (i.e., 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 Corp. 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, OKLA. STAT. tit. 52, §§ 542-547 (Supp. 1991), 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, 725 P.2d 278 (Okla. 1986), appeal dismissed 479 U.S. 1073. 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 Miss. 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). As Professor Kuntz has observed, there are three methods to correct imbalancing: (1) balancing in kind or balancing volumes; (2) balancing in cash, periodically; and (3) balancing in cash, upon deletion of the reservoir. E. Kuntz, The Law of Oil and Gas, § 77.3(f) (1978). Query, how should unleased mineral interests be handled? Should cash balancing always be employed, even where the unleased mineral interest owner who refuses to execute a Gas Balancing Agreement objects to the current sale of its portion of the gas?

In the landmark decision of Beren v. Harper Oil Co. the Oklahoma Court of Appeals analyzed the issue of how to achieve gas balancing in the absence of a gas balancing agreement. The court here coined the phrase "equitable balancing." The facts typify the common problems of imbalances which occur as a consequence of split stream sales.

Three of the five working interest owners sold their gas to Arkansas Louisiana Gas Company (ARKLA). The other two working interest owners sold their gas to Oklahoma Natural Gas Company (ONG). Although the operating agreement mandated that each party separately dispose of its proportionate share of gas, ONG refused to accept the gas because it was not compatible with the pipeline pressure. The two non-producing parties did not install a compressor and the Operator
(correct in the court's opinion) properly sold the entire gas to ARKLA.

The court found that in the absence of a gas balancing arrangement, the parties were presumed to have adopted existing "general trade usage." After discussing the three methods available to correct imbalances previously addressed by Professor Kuntz, the court held that it was industry custom to balance in kind whenever possible and to use cash balancing when in kind balance was impossible due to reservoir depletion.

Notwithstanding the industry custom, the court went on to formulate the remedy of "equitable balancing." Although the court noted that the well was depleting, the well was still producing and a part if not all of the imbalance could have been eliminated through in kind balancing. That is, the underproduced parties could make-up all or a portion of their imbalance by taking all or a proportionately greater percentage of the gas stream until the parties were in balance or the well depleted, whereupon cash balancing could be used to equalize the parties' position. The court elected to require a cash balancing. Interestingly, the court did not enunciate the factors or the methodology which should be used in ascertaining the value of the underproduced parties' gas. The court was no doubt influenced by the fact that gas prices had increased between the time the underproduced parties had not sold their proportionate share of the gas and the time they demanded the right to make-up the imbalance in kind. Simply put, it would not be equitable to allow a party which did not market its gas to be permitted to make-up in kind at some future date when gas prices have increased and unjustly enrich itself at the expense of those that punctually market their entitlement. It is interesting to note, however, that most gas balancing agreements permit parties to make-up deficiencies in the future by taking in kind a specified percentage of the available gas. Without the parties' expressed agreement, the court was unwilling to sanction the manipulation of gas sales to permit a working interest owner to capture a higher price for its gas, at the expense of another working interest owner who was timely selling its proportionate share of the produced gas.

In United Petroleum Exploration, Inc. v. Premier Resources, Ltd., the Federal District Court for the Western District of Oklahoma expressly stated that it was following Beren v. Harper Oil Co. and 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 stated "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." The court went on to state "[t]he general custom of the industry to balance in kind, if possible, should not be afforded greater preference than a cash balancing when a balancing in kind would be inequitable to any party. Rather, the method of balancing chosen should reflect an intention by the court to restore the underproduced party to the position which he would have occupied if the imbalance had not occurred." In holding that the proper remedy was one of cash balancing, the court stated that the "actual price received . . . for the gas sold" should be used to equalize the parties' respective positions whenever the "actual price received" is no less than the fair market price.
'The Louisiana Appellate Court in *Amoco Production Company v. Thompson*, 516 So.2d 376 (La. App. 1987), *writ denied*, 520 So.2d 118 (La. 1988) held that the Commissioner of Conservation has the requisite power to partition co-owned gas produced from a compulsory unit and to order balancing. The court ruled in upholding the Commissioner's authority, that "[b]ecause the commissioner has the power to partition the gas in kind, he must have the power incidental thereto to order balancing. . . ." The court went on to hold that the Commissioner has the authority to order an accounting either in kind or in cash, depending on the circumstances, but that cash balancing would not be used unless it was "the only practical relief." The court did not elaborate on the definition of what is meant by the term "the only practicable relief."

The Fifth Circuit in *Pogo Producing Company v. Shell Offshore, Inc.* 898 F.2d 1064 (5th Cir. 1990) rules that Pogo Producing as an underlifter could not demand cash balancing based on historical gas prices at the time the imbalances occurred, where such demand is not equitable under the circumstances. Pogo Producing underlifted in excess of 1 bcf between 1982 and 1985. The District Court found that the average price during this period was $3 to $4 per mcf and that by the end of 1986 the price had declined to approximately $1.50 per mcf.

As a consequence of the price decline, Pogo Producing, of course, sought a cash balancing based on historic costs. The court was reticent to permit Pogo Producing to obtain the benefits of the historical higher price paid for gas, where Pogo Producing deliberately decided not to sell its gas. Interestingly, the Operator gave Pogo Producing the opportunity to market its share of gas to the Operator's purchaser. Pogo Producing, apparently believing that prices would increase further, declined the Operator's offer to market. The court held that balancing in kind is the preferred method of remedying underproduction. And that is where there may be circumstances which justify cash balancing (other than where the property is nearing depletion). Pogo Producing's assertion that it was unable to market did not trigger cash balancing. Indeed, it would have been inequitable to permit Pogo Producing to cash balance at the expense of those that timely sold their gas.

Glenn Taylor, in an article for 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 wellbore 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 current 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). Generally, it is the most equitable balancing on the proceeds received by the overproduced parties.

In each of the above cases the courts grappled with what to do where a gas balancing agreement was not entered into. Several cases have, however, had the
opportunity to address situations where gas balancing agreements have been executed. In *Chevron U.S.A., Inc. v. Belco Petroleum Corp.*, 755 F.2d 1151 (5th Cir. 1985), the court applying Louisiana law interpreted a gas balancing agreement to provide only for in kind balancing to remedy an imbalance. In this case, Chevron farmed out to Belco, reserving a 1/8 overriding royalty which could be taken in kind. The gas balancing agreement, consistent with many offshore forms, permitted the underlifter to make-up by taking its proportionate share of the gas plus up to 25% of the gas. Belco began to sell the gas stream for its account exclusively. It took Chevron three years to obtain a Federal Power Commission certificate and by that time the primary production of the field had depleted. Chevron naturally sought a cash balancing. Belco argued that the specific gas balancing agreement in question did not allow (address) cash balancing. Rather, Belco argued the sole remedy was in kind balancing in accordance with the 25% make-up provision. The trial court, relying on the principles of unjust enrichment, found an implied cash balancing provision and awarded Chevron $600,000.

The Court of Appeals narrowly construed the gas balancing agreement and ruled that the parties had contractually decided that in kind balancing was to be the exclusive remedy to cure imbalances. Belco, the court found, breached no contractual duty to Chevron. By employing the form of gas balancing agreement used, an underproduced party bore the risk that the reservoir would deplete before the imbalance was cured. Apparently, the form of gas balancing agreement used was submitted by Chevron. The court refused to rewrite a contract and "do equity" where Chevron, a sophisticated oil company, elected to use a form agreement that did not ultimately inure to its benefit. The court stated "that the underproduced party bore the risk that the gas well would deplete before the underproducer could produce, and thus own, all or any of its share." Scott Lansdown observed that the decision in *Chevron v. Belco* "is the result of an overly mechanical application of the balancing agreement to the facts before the court." Lansdown, *The Use of Gas Balancing Agreements in Texas*, CORPORATE COUNSEL REVIEW, Vol. 2, No. 2 (1988), at 4. Lansdown states that "the right to an equitable balancing is generally recognized." And he is, therefore, able to conclude that in accordance with equitable balancing, a party should not be foreclosed from obtaining a cash balancing settlement upon depletion, even where the relevant gas balancing agreement does not so provide for such a result.

Although the court in *Chevron v. Belco* did no doubt adopt a narrow interpretation which could be viewed as strictly a "mechanical application," is this not what Chevron proposed in the gas balancing agreement which was eventually executed? Should our courts rewrite agreements, because one party failed to anticipate the occurrence of one or more events or because a party simply made a mistake? Here, there is no evidence of a mutual mistake and, therefore, reformation is not in order. In the name of equity, our courts have during the past several decades felt obliged to rewrite contracts. These courts in an effort to cure individual inequities, have done a disservice to the certainty of contracts and the law. Would the state of the law not be better off, if the courts showed a little judicial restraint? We as a society can no longer be confident that our agreements will be respected and as a consequence a party who suffers a loss frequently seeks resort in the courts. What *Chevron v. Belco* teaches is that there is no substitute for anticipatory and
prophylactic lawyering. Simply stated, if you do a poor job in drafting your agreements don't count on the courts to bail you out.

In the interesting case of *Andrau v. Michigan Wisconsin Pipeline Co.*, 712 P.2d 372 (Wyo. 1986), Andrau as a Non-Operator failed to pay its share of drilling expenses. Under the relevant JOA, the Operator had a lien for the unpaid expenses. As you may have guessed by now, the price dramatically decreased during the period Andrau failed to take its proportionate share of production. Andrau, of course, claimed that under the gas balancing agreement it had the right to a cash balancing at historic cost. During the underlifted period, the Operator was able to sell the gas for $7.50 per mcf. The price at the date of trial was, however, only $2.50 per mcf. Andrau argued that the Operator had a fiduciary duty to dispose of its share of the gas and that it would be unjust to foreclose on its interest. The court did not accept either of these claims. In its finding the court held that an Operator who had the foresight to make a good contract did not have to share the fruits of its adroit business acumen with another who was not as astute. The court correctly observed that if it accepted Andrau's arguments "then those in his position would have the enviable choice of selling their share of production under the Operator's contract, or under their own contract if the market value increases." Whether a gas balancing agreement exists or not, it is not equitable to permit an underlifter to elect cash balancing based on historical prices or in kind balancing depending on which methodology is more valuable to the underlifter, unless such an election is sanctioned by an explicit provision in the gas balancing agreement.

The court in *Killgore v. Texaco*, 1987 WL 6203 (E.D. La. 1987) applied a creative approach to both compensate Killgore and punish Texaco. Texaco failed to deliver Killgore's gas during a three month period. Thereafter, Texaco overdelivered gas to Killgore, but the well depleted leaving Killgore in an underbalanced position. To compensate Killgore the court required Texaco to pay Killgore an amount equal to what it would have received had it been able to sell the gas during the three month period. This amount was characterized as damages calculated at $3 per mcf. For the balance of the underlifted amount, Killgore was paid based on the amount actually received by Texaco, which amount was calculated at 38¢ per mcf.

Operators may be required under gas balancing agreements to properly administer and account to the Non-Operators for the sale of their gas. In *Pelto Oil Co. v. CSX Oil & Gas Corp.*, 804 S.W.2d 583 (Ct. App. 1991), on appeal, the Houston, Texas, court of appeals is confronted with the question of how to handle a situation where the Operator erroneously sold the gas of one Non-Operator for the account of a second Non-Operator. And, as a consequence of a fall in the price of gas after such sales were discovered, the second Non-Operator refused to pay such proceeds to the other Non-Operator. Also see *Teel v. Public Service Co. of Oklahoma*, 767 P.2d 391 (Okla. 1985), where a pipeline purchaser was found to have converted gas after receiving notice that the cotenant/Operator did not have the authority to dispose of the gas. But see *Anderson v. Dyco Petroleum Corp.*, 782 P.2d 1367 (Okla. 1989) which limits the application of *Teel*. Dyco and the pipeline purchasers were sued by the Non-Operators for conversion. The Non-Operators claimed that they had a right to ratify the gas purchase contracts and that the pipelines had an obligation to purchase the gas ratably from each working interest owner in the well. The
Oklahoma Supreme Court found for Dyco and held that the common purchasers statutes in Oklahoma required pipelines to purchase gas ratably among common source of supply, but there is no requirement to purchase ratably among interest owners in the same wellbore. As to their conversion claim, the court narrowly interpreted Teel to exclude pipelines under the facts of Dyco and ruled that Dyco, as tenant in common has the right to separately take and dispose of its share of production, subject to a duty to account. Consequently, as a tenant in common with the Non-Operator/plaintiffs, Dyco could not be a converter. But see Energy Search Petroleum, Inc. v. Amoco Production Co., No. 87-C-375-E Order (N.D. Okla. Apr. 20, 1989) (unpublished).

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 ration 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.

Courts have generally embraced the philosophy that each party should timely sell their gas and the adoption of this philosophy has affected their decisions. Should this philosophy be perpetuated? Do we as a society want to encourage sales even at distressed prices? Why should a producer be "forced" to sell, assuming his lease would permit him to temporarily shut-in the well? Isn't it in the best interest of both the producer and the royalty owners to temporarily withhold all or a portion of the production if prices are expected to rise? Although some on Wall Street claim to be able to do so, no one can correctly predict the future, but why limit a producer's choice?

The present philosophy dumps excess supply on an already depressed market, further depressing prices. A philosophy which gives the producer greater discretion of when to sell based on the economics would act to decrease the supply when prices were low which would help firm prices and increase the supply when prices began to rise. This increase in supply would mollify upward pressures on gas prices.

Although courts articulate this philosophy and talk in terms of the producer's duty to timely sell its gas, the few courts that have considered this issue have not explicitly punished a party for not selling its gas. Rather, the courts have not permitted a party who has not timely sold its gas to be rewarded by reaping a financial benefit as a consequence of its underproduced status. I posit that a change in philosophy which, gives a producer such discretion is consistent with the gas balancing decisions to date.

A variety of gas balancing agreements are being used today. The balance of this section will be devoted to an analysis of the major components of typical gas
balancing agreements.

Most gas balancing agreements begin by expressing the parties' intentions that each party take and dispose of its proportionate share of gas. And the failure to take and dispose of such gas shall result in the right of a party to make-up such deficiency, in accordance with a specified procedure. Thereafter, it is customary to include a definitional section.

The Operator will be responsible for furnishing the parties with periodic statements (usually monthly) showing the volume of gas taken and the underlift or overlift status of each of the parties. Some gas balancing agreements explicitly exonerate the Operator from any liability caused by an overlifter who fails to balance (cash or in kind) with an underlifter. In this regard, it is interesting to consider *Pelto Oil Co. v. CSX Oil & Gas Corp.*, supra.

Balancing procedures permit the underlifter to make-up its shortfall by taking an additional amount of the gas produced. Most agreements limit this additional amount to 25% of the overlifter's share of the gas. Some agreements provide for a 50% limitation. This agreement imposes a 25% limitation by stating that an overproduced party shall never be required to take less than 75% of its percentage interest share of gas during any month. Scott Lansdown suggests that this limitation can work an injustice where the well is fast depleting and there is insufficient remaining production to bring the parties in balance. Believing in kind balancing is to be favored, Lansdown suggests the incorporation of a provision which would allow the underproduced party to take a greater share of production where it can be demonstrated that there is no reasonable possibility that an underproduced party can make-up its underproduced balance. Lansdown recognizes that such a provision would result in disputes and litigation, and he alternatively proposes that the limitation be based on the extent of the existing imbalance. He realizes that this too is no panacea as it will substantially complicate the Operator's administrative obligations. Some companies have recently begun incorporating provisions which restrict make-up of imbalances during the winter months when gas demand is greatest and the price is usually higher. Parties to a gas balancing agreement should not be able to manipulate its sales so that it takes little or no gas during the summer months, when gas prices are traditionally depressed and makes up the shortfall during the winter months when prices are traditionally higher.

Generally, cash balancing occurs when the well depletes and the parties are not in balance. Some gas balancing agreements contain periodic cash balancing provisions. Periodic cash balancing favors the underlifter, in that the underlifter is not as badly penalized by the loss of the time value of money, i.e., interest. Having said this, however, if the gas balancing agreement is designed to encourage the timely taking of gas, why should the underproduced party not be so penalized for not timely taking his share of gas? During the first half of the 1980s, several gas balancing agreements contained gas storage provisions, whereby if the price of gas increased above a defined inflation-adjusted value between the time the overproduced party sold the gas and the time the underproduced party sold its gas, any appreciation above the inflation-adjusted value was to be paid or earned by the overproduced party. The provisions provided monetary disincentives for parties to withhold selling
their gas in the hope that gas prices will increase. Periodic cash balancing runs afoul of the basic notion that each party should timely market its share of gas. To permit periodic cash balancing is to encourage parties to manipulate their gas sales. Query, is this bad?

Although it can be characterized as periodic gas balancing, it may well be beneficial to require cash balancing when an overlifter sells, assigns or transfers all or a portion of its interest covered by a JOA and a gas balancing agreement. The failure to do so may permit a party who greatly overproduces to transfer its interest, late in the life of a well, to a third party who refuses or is financially unable to satisfy its final cash balancing obligations. Technically, the assignor would still be liable to the parties unless each party consented to such transfer by way of a novation. Pursuant to such a novation, each party would expressly consent to look exclusively to the assignee for all prior, present and future debts, liabilities and obligations. Industry has not traditionally used novation agreements and has frequently confused the distinction between an assignment and a novation. If cash balancing was required before an overproduced party was allowed to sell, assign or transfer its interest, the remaining parties would at least be able to eliminate the risk of not being paid in a final cash settlement for the amounts due on the date of transfer.

Gas balancing agreements can apply to a well, a reservoir, a National Gas Policy Act (NGPA) 15 U.S.C. §§ 3301-3432 (1988), category, a drilling and spacing unit, a formation, the Contract Area under a JOA, etc. Many gas balancing agreements balance on a well basis, with some superimposing a NGPA vintage requirement on the obligation to balance. Lansdown recommends the use of a reservoir-by-reservoir approach. In support of this recommendation he states "if a well is reworked to different depths, the period during which balancing occurs could stretch on for decades and this will concomitantly increase the accounting burden and the chance of accounting errors." While I am not particularly persuaded that the risk of accounting errors justifies the adoption of a reservoir approach, Lansdown also observes that that final cash settlement may be significantly delayed where a gas well is recompleted as an oil well, and such oil well also produces a small amount of casinghead gas. Clearly, under this scenario an underproduced party may not be able to balance in kind and may have to wait many years before final cash balancing. While Lansdown is undoubtedly right, once again we have to ask who the gas balancing agreement should be written to protect, the underproducer or the overproducer who has timely sold its gas?

Probably the most contentious feature of the Gas Balancing Agreement involves the provision addressing how royalties should be paid. This Gas Balancing Agreement states that "[e]ach 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." 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?

Lansdown circumvents this conundrum by recommending that out-of-pocket royalties be paid without future adjustments to reflect the sale of the underproducer's share of production. This theory is supported by the proposition "that the obligation to pay royalty attaches to the lessee's proportion of actual gas production, without regard to the provisions which the Gas Balancing Agreement makes for storing and making up gas. If that assumption is accepted, it makes no sense to argue that, having paid royalty on actual production, a lessee's obligation should later be adjusted by virtue of the provisions of the Gas Balancing Agreement which were deemed to be inapplicable to the royalty obligation in the first place." Lansdown at 19. Lansdown then suggests that to avoid disputes with lessees over the application of this theory, lessees should consider explicitly incorporating such language in their division orders. What happens when the lessors refuse to accept such language? Since the law of some states, including Texas, permits a lessor to revoke a division order, is the inclusion of such language truly helpful? It is this author's opinion that notwithstanding the superficial attraction of this approach this theory is not firmly grounded and it is likely to short circuit both the filing of the first lessor lawsuit after an increase in price.

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

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. Volumetric Balancing.

2.1 Balancing. Volumetric balancing hereunder shall apply to each separate well located on the properties covered by the Operating Agreement.

2.2 Definitions. The term "Cumulative Underproduction" means the amount by which the cumulative volume of gas taken by a party within a particular well is less than the cumulative volume that the party was entitled to take according to such party's percentage ownership interest in such well; the term "Cumulative Overproduction" means the amount by which the cumulative volume of gas taken by a party within a particular well exceeds the cumulative volume that party was entitled to take within such well according to such party's percentage ownership interest in such well; the term "Underproducer" or "Underproduced Party" means a party credited with Cumulative Underproduction; the term "Overproducer" or "Overproduced Party" 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.

2.3 Operator's Information Requirements and Statement Obligations. Each party taking gas shall notify Operator or cause Operator to be notified, at least two (2) business days prior to the applicable pipeline's nomination deadline, of the gas volumes such party wishes to take during the following month. No party may take more gas volumes than it is entitled to pursuant to the terms of this Agreement. Each party shall also provide such information required for the Operator to properly allocate monthly gas production, including, but not limited to, the time period for which specific gas volumes are going to be taken, the transporting pipeline, the transporting pipeline's contract number and the pipeline's meter or station number. On or before the end of each calendar month Operator shall furnish the parties hereto a written statement showing for each well for the preceding month: (1) the quantities of gas to which each party was entitled; (2) the total quantity of gas taken by each party; and, (3) the Cumulative Overproduction or Cumulative Underproduction of each party under this Agreement. The Non-Operators shall be responsible for providing all data and information specified herein to enable the Operator to perform the duties contemplated by this paragraph.

2.4 Volumetric Make-Up. An Underproducer may give written notice to Operator and all other parties hereto at least 15 days before the beginning of a calendar month, stating its desire to take Make-Up Gas during that month. Each Overproducer shall promptly notify its purchaser so that such purchaser will adjust its takes to accommodate the Make-Up. The Underproducer shall thereupon be entitled to take Make-Up Gas in accordance with the rates set out below but not in excess of its Cumulative Underproduction. To allow for an Underproduced Party to make up and to balance its gas account, an Underproduced Party shall be entitled to take and/or deliver to a purchaser its full entitled share of gas produced from such well (less any used in operations, vented or lost) plus an amount up to an additional 50% of the monthly quantity of gas attributable to the Overproduced Party or Parties working interest during the "Off-Peak period" defined as the months of April through October. During the "Peak Period," herein defined as the months of November through March, the
Underproduced Party shall only be entitled to take an additional 25% over its entitled share. If more than one Underproduced Party is entitled to take additional gas, they shall divide the additional gas in proportion to their respective working interest ownership in the property covered by the Operating Agreement. The first gas made up shall be assumed to be the first gas underproduced.

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 Procedure. Upon permanent cessation of all gas production from the well, the Operator shall submit notice of such cessation to all parties in the well. If all the parties in the well have not achieved volumetric gas balance in the well at the time of such notice, then within 30 days of submitting the notice, the Operator shall furnish to all parties a statement showing the final Cumulative Overproduction and Cumulative Underproduction of each party in the well, and the month and year in which it accrued. In determining the timing of accruals, Make-Up Gas shall be applied against Cumulative Overproduction on a first-in-first-out basis. 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 based on the price the Overproducer actually received for the Cumulative Overproduction. Value of such overproduction shall be based on the net proceeds received for such overproduction at the time the overproduction occurred. Based upon the statements furnished by Overproducers, the net amount owed by or to each party combined shall be calculated by Operator and furnished to all parties in a final cash balancing statement.

3.2 Settlements. Within 30 days after receipt of Overproducers' statement showing value, each Overproducer shall pay each Underproducer in accordance with the statement and without interest. After such 30-day period, any unpaid amount shall bear interest in accordance with the accounting procedure, Exhibit C to the Operating Agreement. 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. The Operator shall not be liable for any misstatements or misrepresentations contained in statements received from others nor shall it be responsible for any collection efforts by any Underproduced Party against any Overproduced Party.

4. Payments on Production.

Each party shall pay all 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 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.

5. Taxes.

It is agreed that all parties shall report and pay income taxes, severance taxes or other taxes on production based on what the parties actually produce and take.
6. **Transfers of Interest.**

Prior to any transfer of an Overproduced Party's interest in any well covered hereby to a third party, not a party hereto, such Overproduced Party shall give notice of such transfer to all Underproduced Parties in such well and commence procedures to effect a cash settlement for its Cumulative Overproduction accrued through the last full month prior to the effective date of such transfer. The procedure and value for the cash settlement shall be the same as that set forth in Sec. 3.1 and 3.2, above, except that the timing will start from the time such transferring Overproducer gives notice of its intent to transfer after which it shall have 60 days to render its statement of value based on the latest month's statement of Cumulative Overproduction rendered by the Operator. Liability for the cash settlement shall survive the transfer of the Overproduced Party's interest.
The form provided is similar to the Gas Balancing Agreements commonly being used. The Agreement begins by stating the gas balancing's underlying principle that gas volumes not taken by a party can be taken by the other parties. The Agreement then discusses the mechanics involved in the taking and balancing of gas volumes. A few issues should be noted about this form. These issues are discussed previously.

-- Balancing is to occur on a well basis not a property basis.

-- Each party that anticipates taking gas is to notify the Operator of the volumes, timing, pipeline and the contract number and meter or station number. The Operator will furnish the Non-Operators with a report stating each party's entitlement, the total gas taken and the cumulative underproduction or overproduction. Prices are not to be provided for antitrust reasons. This information will enable Operators to effectively deal with pipelines and will enable the Operator to timely present the parties with an informative report which outlines the gas available, what has been taken and by whom and what each party can take in the future.

-- Make-up gas is limited to 50% of a overproduced party's entitlement during the off-peak period (April through October) and 25% during the peak period (November through March). In an offshore context, parties may want to increase the make-up limitations, from 50% and 25% to 75% and 50%. Parties should not be able to manipulate their sales so as to enable them to have a greater amount of gas to sell in the winter months when the gas price is historically higher.

-- The Gas Balancing Agreement does not effect sales of crude oil, condensate or other minerals.

-- Parties must timely bear all costs and expenses, whether or not they are taking gas.

-- The Operator will notify the Non-Operators of a permanent cessation of production. Within 30 days of such notice, the Operator will provide a statement of each party's overproduction or underproduction. Within 60 days thereafter, each overproducer will furnish the price it received for the cumulative overproduction. Payments to each underproducer will be made within 30 days thereafter.

-- Each party is to pay all royalties, overriding royalties, production payments and other such payments on production due under law, lease or contract. Each party can decide for itself whether, under the specific circumstances, out-of-pocket royalties should be paid. No party can be forced to make an out-of-pocket royalty, but each party agrees to indemnify the other parties against all claims, loses or liabilities arising out of its failure to make such payments.
-- Each party will pay income taxes, severance taxes and other production taxes based on what such party actually takes.

-- Transfers of an overproduced party's interest will give rise to a cash settlement, so as to compensate the underproducer for the imbalance.
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

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 80-1.4 of Title 41 of the Code of Federal Regulations is incorporated by reference (as permitted by Section 80-1.4(d) of said Regulations) 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 80-1.40.]

      If required under 41 CFR Sec. 80-1.40, 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 $30,000 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 80-741.4 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 80-741.5.]

      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 80-741.5 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 80-250.4.]

      The affirmative action clause prescribed in Section 60-230.4 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.

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It is 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, 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.

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 $300,000 which are required to include the small business and small disadvantaged business utilization clause above and offer subcontracting possibilities, Federal Register, Vol. 45, No. 32, 8/9/80.]

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 $300,000 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 $300,000 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.

2. The contractor/supplier further agrees to insert, in any subcontract hereunder which may exceed $300,000 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. 91-804) and Section 308 of the Federal Water Pollution Control Act (33 U.S.C. 1251, et. seq., as amended by Pub. L. 92-300), 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 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. 1837c-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.
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. There is a good deal of discussion as to whether exploring for and producing oil and gas on Federal Leases subjects companies to the mandates of the Non-Discrimination and Non-Segregated Facilities requirements. Rather than directly address this issue, most companies comply with the requirements.

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. Some companies have adopted an abbreviated form which incorporates by reference the required order and laws without reciting the complete language of such orders and laws.
EXHIBIT "G"
TO OPERATING AGREEMENT

TAX PARTNERSHIP AGREEMENTS

On the following pages you will find two Tax Partnership Agreements.
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.

1. *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.

2. *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.
EXHIBIT G
TO OPERATING AGREEMENT

TAX PARTNERSHIP PROVISIONS

Section 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.

Section 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 of 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 provide the Internal Revenue Service with sufficient information for purposes of Code §§ 6623 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 the filing of its income tax return, the TMP need not be notified.

2.5 Requests for Administrative Adjustments. 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.

Section 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, (d) to report income on a calendar year basis, and (e) to make the election provided for in Code § 754.

3.2 Depletion. Solely for FMV capital account purposes, depletion shall be calculated by using simulated percentage depletion within the meaning of Treasury Regulation § 1.764-1(b)(2)(iv)(k)(2).

3.3 Other Elections. Any other election 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".

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Section 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 leases 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 indicated in Exhibit J-1 hereto or in a separate written agreement assumed to equal the adjusted basis, as defined in Code § 1011, of that property unless the Parties agree otherwise.

Section 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) The income attributable to take-in-kind production will not be reflected on the tax return.
Section 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. 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. 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. 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.

Section 7: Transfers, Survivorship and Correspondence

7.1 Transfers. 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).

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 the tax manager of the TMP at the address provided in the Operating Agreement.
FAIR MARKET VALUE OF PROPERTY CONTRIBUTED TO TAX PARTNERSHIP

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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, as a consequence of regulations promulgated under Code Section 704(b) individually and when coupled with Code Section 613A and Code Section 704(c), the use of tax partnerships could in some situations adversely alter the anticipated underlying business economics of a 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 the business community, industry is considering minimizing the use of the 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.

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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
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).

[bNote: 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:

____________________________________________________________________

____________________________________________________________________

____________________________________________________________________
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: (1) require the application of a very complex body of tax law; and (2) 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: (1) prepare and file all required federal and state partnership income tax returns; and (2) 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: (1) keeping the IRS informed of the parties' identification data; (2) filing "requests for administrative adjustments" (see Code § 6227); and (3) 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: (1) to expense currently IDC; (2) to depreciate property in the most accelerated manner; (3) to use the accrual method of accounting; and (4) 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: (1) the gain on the disposition is equal to the sales proceeds without reduction for any remaining undepreciated tax basis; and (2) 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 depletible 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: (1) the partnership's assets be distributed in accordance with capital account balances; and (2) 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: (1) the interest of each party in the oil and gas leases and associated properties made subject to the partnership; and (2) 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: (1) increased by contributions of money and property and by partnership allocations of income and gain; and (2) 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: (1) 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 (2) 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:

<table>
<thead>
<tr>
<th></th>
<th>Party &quot;A&quot;</th>
<th>Party &quot;B&quot;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contribution</td>
<td>$ 16.0 M</td>
<td>$100.0 M</td>
</tr>
<tr>
<td>Deductions</td>
<td>--</td>
<td>(100.0 M)</td>
</tr>
<tr>
<td></td>
<td>$ 16.0 M</td>
<td>--</td>
</tr>
</tbody>
</table>

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: (1) increase Party "B's" capital account balance to $2.5M; (2) be distributed to Party "A", thereby reducing Party "A's" capital account balance to $2.5M; and (3) 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). First, 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. Second, 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.