

9. "Technical Employees" shall mean those employees having special and specific engineering, geological or other professional skills, and whose primary function is the handling of specific operating conditions and problems for the benefit of the Subject Interests.

II. Direct Costs

1. Rentals and Royalties.

Direct costs shall include (i) lease rentals (including delay rentals and shut-in gas payments) and (ii) royalties burdening the Property which were in existence at the Closing Date.

2. Labor.

- A. (1) Salaries and wages of Operator's field employees directly employed on the Property in the conduct of Operations.
- (2) Salaries of First Level Supervisors in the field are not covered by the Overhead rates.
- (3) Salaries and wages of Technical Employees directly employed on the 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 under Paragraph 2A of this Section II. Such costs under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable under Paragraph 2A 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 under Paragraphs 2A and 2B of this Section II.
- D. Personal Expenses of those employees whose salaries and wages are chargeable under Paragraph 2A of this Section II.

3. 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 under Paragraphs 2A and 2B of this Section II shall be Operator's actual cost not to exceed twenty percent (20%) or the percent most recently recommended by the Council of Petroleum Accountants Societies of North America.

4. Material.

Material purchased or furnished by Operator for use on the Property as provided under Section IV. Only such Material shall be purchased for or transferred to the 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.

5. Transportation.

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

- A. If Material is moved to the Property from the Operator's warehouse or other properties, no charge shall be made for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available.
- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point. No charge shall be made for moving Material to other properties belonging to Operator.
- C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking costs of \$200 or less excluding accessorial charges.

6. Services.

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 9 of Section II and Paragraph 1.ii of Section III. The cost of professional consultation services and contract services of technical personnel directly engaged in connectio^s with the Property. The cost of professional consultant services or contract services of technical personnel not directly engaged on the Property shall not be charged.

7. Equipment and Facilities Furnished by Operator.

A. Operator shall charge 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 investment not to exceed the Prime Rate plus two per cent per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Property.

B. In lieu of charges in Paragraph 7A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

8. Damages and Losses to Property.

All costs or expenses necessary for the repair or replacement of 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.

9. Legal Expense.

Expense of handling, investigating and settling litigation or claims, discharging of liens, payment of judgments and amounts paid for settlement of claims incurred in or resulting from operations under the agreement or necessary to protect or recover the Property, except that no charge for services of Operator's legal staff or fees or expense of outside attorneys shall be made; provided, however, that a charge may be made for the expense of outside

attorneys in connection with any actions brought by Operator against third parties which actions a prudent operator would determine to bring or to defend actions brought by third parties against Operator in connection with the operations hereunder. All other legal expense is considered to be covered by the overhead provisions of Section III.

10. Taxes.

All taxes of every kind and nature assessed or levied upon or in connection with the Property, the operation thereof, or the production therefrom and which taxes have been paid by the Operator.

11. Insurance.

Net premiums paid for insurance required to be carried for Operations. In the event Operations are conducted in a state in which Operator may act as self-insurer for Workmen's compensation and/or Employers Liability under the respective state's laws, Operator may, at his 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.

12. Other Expenditures.

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

III. Overhead

1. Overhead -- Drilling and Producing Operations.

- (i) As compensation for administrative, supervision, office services and warehousing costs, Operator shall charge drilling and producing operations on the Fixed Rate Basis provided below. 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 2A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or, except as otherwise provided in this Schedule C, matters before or involving governmental

agencies shall be considered as included in the
Overhead rates provided for.

(ii) The salaries, wages and Personal Expenses of Technical Employees not directly employed on the Property shall be covered by the Overhead rates, and the costs of professional consultants' services and contract services of technical personnel directly employed on the Property shall not be covered by the Overhead rates.

A. Operator shall charge the following rates per well per month:

Drilling Well Rate: Rates competitive with the fees of unaffiliated persons in the area engaged in the business of rendering comparable services.

Producing Well Rate: Rates competitive with the fees of unaffiliated persons in the area engaged in the business of rendering comparable services.

B. Application of Overhead -- Fixed Rate Basis shall be as follows:

(1) Drilling Well Rate

(a) Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for ten (10) or more consecutive days.

(b) Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for ten (10) or more consecutive days.

(c) Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from the date workover operations, with

rig, commence through the date of rig release, except that no charge shall be made during suspension of operations for ten (10) or more consecutive days.

(2) **Producing Well Rates**

- (a) 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.
 - (b) 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.
 - (c) A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.
 - (d) 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.
- C. The well rates shall be adjusted as of the first day of April each year commencing in 1989. 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 Fields Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

**IV. Pricing of Material Purchases,
Transfers and Dispositions**

Operator is responsible for Material and shall make proper and timely charges and credits for all material movements affecting the Property. Operator shall provide all material

for use on the Property. Operator shall make timely disposition of idle and/or surplus Material, such disposal being made either through sale to Operator or sale to outsiders. The disposal of surplus Controllable Material not purchased by the Operator shall be determined by Operator.

1. Purchases.

Material purchased shall be charged at the price, including carrying costs incurred during the 24-month period preceding the sale, paid by Operator after deduction of all discounts received. In case of Material found to be defective or returned to vendor for any other reason, credit shall be allowed when adjustment has been received by the Operator.

2. Transfers and Dispositions.

Material furnished to the Property and Material transferred from the Property or disposed of by the Operator shall be priced on the following bases exclusive of cash discounts:

A. New Material (Condition A)

- (1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Property where such Material is normally available.
- (2) Line Pipe
 - (a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Property where such Material is normally available.
 - (b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing of Paragraph 2A(1) of this Section IV.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as

listed by a reliable supply store or f.o.b. railway receiving point nearest the Property where such Material is normally available.

B. Good Used Material (Condition B)

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

- (1) Material moved to the Property
 - (a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV.
- (2) Material moved from the Property
 - (a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged as new Material, or
 - (b) At sixty-five percent (65%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged as good used Material at seventy-five percent (75%) of current new price.

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

C. Other Used Material (Condition C and D)

(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 2A of this Section IV. 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.

(2) Condition D

All other Material, including junk, shall be priced at a value commensurate with its use or

at prevailing prices. Material no longer suitable for its original purpose but usable for some other purpose, shall be priced on a basis comparable with that of items normally used for such other purpose.

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 by the Operator. Such price should result in the Operations being charged with the value of the service rendered by such Material.

E. Pricing Conditions

- (1) Loading and unloading costs may be charged at the rate of twenty-five cents (25) per hundred weight on all tubular goods movements, in lieu of loading and unloading costs sustained, when actual hauling cost of such tubular goods are equalized under provisions of Paragraph 5 of Section II.
- (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 not control, the Operator may charge 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 Property.

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 Controllable Material.

2. Reconciliation and Adjustment of Inventories.

Reconciliation of a physical inventory with charges against Operations shall be made, and inventory adjustments shall be made by Operator for coverages 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 or change of interest in the Property. It shall be the duty of the party selling to notify all other working interest holders 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.

4. Expense of Conducting Periodic Inventories.

The expense of conducting periodic Inventories shall not be charged.

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