Chapter 10

Oil and Gas Exploration and Development Agreements

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§ 10.01. Introduction.

Companies in the oil and gas industry form relationships with other industry players that they hope will be beneficial to all of the parties. Industry players seek out others who possess something that they lack. Some companies have acquired sizable leasehold acreage but lack the funds to timely develop the acreage. Others have cash to invest but lack the technical know-how to properly develop property. Some industry players have developed a geologic idea for a project but lack the resources necessary to acquire the acreage and develop the property.

Each of the great unconventional gas plays that have dominated the industry news over the last few years\(^1\) — the Barnett Shale, the Marcellus, the Haynesville Shale, and the most recent of the group, the Eagle Ford\(^2\) —

\(^{1}\) Questar Corp. chairman Keith Rattie was quoted as stating that the Haynesville: “may be one of the biggest natural gas fields in the world[,]” *Oil and Gas Investor*, May 26, 2009.

\(^{2}\) “In 1990, unconventional gas – from shales, coal-bed methane and so-called ‘tight’ formations – was about 10% of total U.S. production. Today it is around 40%, and growing fast, with shale gas by far the biggest part.” Daniel Yergin and Robert Ineson, “America’s
require acreage, technical know-how and substantial cash for development. Some of the major players in the unconventional gas plays, such as Chesapeake Energy, Range Resources, Cabot Oil & Gas Corporation, and Chief Oil & Gas, have amassed substantial leasehold acreage. Chesapeake Energy alone has reportedly acquired 220,000 acres in the Barnett Shale and 1.6 million net acres in the Marcellus.

Companies have always needed to allocate their capital among their various projects. To avoid spending all of their capital on one project, companies have historically formed joint ventures or entered into participation agreements with other companies who can help provide additional capital for development. In addition to the ongoing need to properly allocate funds, at a time when companies have needed substantial amounts of capital to develop their acreage, the credit crisis that started in 2008 continues to plague the industry. Capital markets have not fully recovered. Credit remains tight. Companies without sufficient funds to finance development on their own have been actively seeking other industry players who can fulfill their need for cash. So, we have seen a surge in the number of companies that have entered into joint development programs with other companies to develop these unconventional gas plays.

The first step for companies wanting to enter into a relationship for the joint development of a project is to determine what form their relationship will take. The potential forms are numerous, but two of the most common are a joint venture and a contractual arrangement under which the parties agree to jointly explore and develop property without forming a separate legal entity.

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§ 10.02. Joint Ventures.

Some parties who want to jointly explore and develop acreage form joint ventures. Joint ventures are more often used when one company will be controlling the development program for a group of investors. A joint venture is in the nature of a partnership that is formed for a one-time business undertaking. The joint venture is a separate legal entity. The parties contribute acreage and money to the joint venture in exchange for an interest in the joint venture. The costs and profits of the project are typically divided between the joint venturers in relation to their respective participating interests. Given that a joint venture is in the nature of a partnership, each of the joint venturers is jointly and severally liable for the obligations of each other joint venturer with respect to the business undertaking for which the joint venture was formed. Parties to a joint venture incur fiduciary responsibilities to one another and to mutually conduct the venture.

The management of a joint venture is typically divided between a management committee and a manager. Each joint venturer is allowed to appoint a certain number of members of the management committee. The number of appointees can be determined in proportion to the joint venturers’ respective participating interests, with each member of the Management Committee having an equal vote. For example, if one joint venturer has a participating interest of seventy-five percent, such joint venturer could appoint three members of a four-member management committee. As an alternative, each joint venturer may appoint an equal number of members to the committee, for example two each, but the voting power of each committee member would be based on the applicable joint venturer’s participating interest. In such a case, the votes of the members of a joint venturer with a seventy-five percent participating interest would hold the voting power of three times that of the members appointed by the other joint venturer.

Specific activities are performed by the manager of the joint venture. The manager acts as the agent for the joint venture. Typically the manager is responsible for the day-to-day operations of the joint venture and has the authority to bind the joint venture to contracts entered into in the ordinary course of business, subject to established limitations on the amount of obligations incurred by the joint venture in each contract. The manager is also generally responsible for the preparation of reports to be delivered to the management committee, whereas, more major decisions, such as determining the plan of development of the project, are left to the management committee.

§ 10.03. Participation Agreements.

Frequently, companies desiring to pursue an opportunity with other companies do not want to incur liability for the others’ obligations. Industry participants, therefore, often prefer to enter into a contract to govern the joint exploration and development rather than form a joint venture. Such agreements are called by a variety of names including “exploration agreements,” “development agreements,” “joint development agreements” or “participation agreements.” This chapter will refer to such agreements as “participation agreements.” There is certainly no one form of participation agreement. Participation agreements range in length from two-page letter agreements addressing one commitment well to sixty-plus page documents with numerous exhibits attached that cover thousand of acres of land. The simplicity or complexity of a participation agreement results from the size of the area to be covered by the agreement and the business deal struck by the parties.


5 A sample form of an Exploration and Development Agreement is attached to this chapter (herein called the “E&D Form”). This chapter makes some footnote references to sections in the E&D Form as examples of the type of provisions discussed herein.
In a typical participation agreement, the parties pursue an opportunity as co-participants. A participation agreement almost always specifies that neither party has any fiduciary obligation to the other and that the parties specifically disclaim any joint liability or the creation of a partnership or joint venture.


One of the fundamental business issues to be decided by companies entering into a participation agreement is what area of land will be covered by the participation agreement (herein called the “exploration area”). The exploration area is typically defined by geographic area and may also be defined by geological structure.

[a] — Geological Exploration Area.

The parties may want to jointly explore and develop a particular geological structure (a “zone”). For example, in South Texas, the industry has spent years developing the Austin Chalk formation that is directly above the Eagle Ford Shale. Now, with the technology that allows development of unconventional gas, development of the Eagle Ford formation is an attractive objective. Thus parties may want to enter into participation agreements that describe the exploration area as the depths covered by the Eagle Ford Shale formation.

In describing an exploration area by geological structure, the structure needs to be described with some particularity, preferably using parameters established by a geologist. A simple reference to the formation, such as the “Eagle Ford Formation,” is not sufficient. A formation may have different names in the same area. Similar names may describe different formations. To adequately describe a formation it must be identified and located, and its name must be clearly discernible.

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7 Parties often use the term “stratigraphic equivalent” of a formation as depth to be drilled. Defining a geological prospect area by reference to a “stratigraphic equivalent” may
The depths of the formation should be given, and it is preferable to include a reference to an existing well that has tested the intended formation. If a formation has been described in a publication by a state or federal geological surveyor, that description may be the best way to describe the formation. An example of a definition for a geologic exploration area would be:

“Prospect” means the geological formation known as the Eagle Ford formation, as more particularly described by the zone between 10,340’ and 10,590’ measured depth on the Induction Electric Log of the H.R. Smith & Gulf Corporation, #1 George Sealy Estate, API #42-311-01237, underlying the contiguous geographic area described in Exhibit A hereto.

If the exploration area is defined by one or more geological structures, the parties need to determine whether the parties will have the ability to participate in different formations. If there are multiple target zones, can a participant elect to participate in one target zone but not another? What if a participant holds interests in a zone that is below or above the target zone? If the parties agree that each party will not be required to participate in all zones, the participation agreement needs to address how the parties will conduct operations so that they will not interfere with operations in the other formations. If leases are jointly held with third parties who are not parties to the participation agreement, such issues will need to be addressed in a separate agreement, typically termed a cooperation or logging agreement.

The issues to be addressed when parties are simultaneously developing different formations include the granting of reasonable access to the land for pose issues. Professor John S. Lowe writes that “Reasonable geologists may disagree as to whether particular formations or zones are stratigraphic equivalents, and even articulate geologists may have difficulty explaining its applications to judges and jurors in terms that they can understand.” Further, the terms have three different meanings: time-stratigraphic (rocks formed during a specific time) biostratigraphic (rocks that contain similar fossils), and rock-stratigraphic equivalents (mappable rock layers with distinctive top and bottom boundaries). Professor Lowe states that another potential issue is that “a stratigraphic equivalent may not exist.” John S. Lowe, “Analyzing Oil and Gas Farmout Agreements,” Vol. 41 Sw. L. J. 759, 825-26 (1987).
exploration and development and the use and allocation of costs of existing and new facilities that serve both formations. The drilling party should give the non-drilling party notice prior to the spud date. Parties often agree to share information if they obtain information about the formation the other party is developing. For example, a party who is developing a deep formation would agree to share information it obtains regarding a shallower formation with the holders of the shallow rights, insofar as such information pertains to the shallower formation.8

Parties with rights in different formations should also address the retention of the shared leases, including a mechanism for the payment of delay rentals and shut in well payments. One party may be granted the primary responsibility for making such payments with the other parties agreeing to pay their proportionate shares. To prevent a party from bearing the financial risk of the other parties failing to perform, the agreement may require the parties to pay their proportionate share of such payments in advance to the party with the primary responsibility for making the payments to the lessor. As an alternative, a party who fails to pay its share of the delay rentals or shut in well payments can be deemed to have conclusively assigned all of its rights under the applicable shared leases to the parties who paid their share of the payments.

[b] — Geographic Exploration Area.

The exploration area is typically defined by a certain geographic description. The primary issue is how much acreage will be included within the exploration area. In some instances, the parties are interested in exploring large amounts of acreage and, therefore, designate entire counties as being included in the exploration area. In other instances, the parties are interested in exploring and developing acreage in which the parties already own interests and, therefore, define the exploration area by reference to such acreage.

8 For example, a company logging a well in the Eagle Ford may need to drill through a part of the Austin Chalk, which overlays the Eagle Ford. The information in the well log that pertains to the Austin Chalk would be valuable to another party involved in developing the shallow rights.
land or lease interests as described on an exhibit attached to the exploration agreement.

It is important that the parties designate the exploration area with sufficient particularity to meet the standards of the statute of frauds, or its equivalent. The statute of frauds provides that all instruments relating to real property or contracts that cannot be performed in one year must have all material terms reduced to written form.9 Under the statute of frauds, an agreement must include within itself, or by references to another existing writing, the means or data to clearly identify the land that is subject to the agreement. A failure to satisfy the statute of frauds will result in the agreement being unenforceable.

A participation agreement must, therefore, specifically define the exploration area.10 A description of an exploration area as covering all lands within a county is sufficient. Maps may or may not be sufficient depending on the level of specificity included in the map. For example, in Guenther v. Amer-Tex. Const. Co.,11 the appellate court held that a map describing land subject to a contract to convey did not satisfy the statute of frauds because, among other things, the map did not show the width or length of boundary lines, did not show the approximate size of the tract or the number of acres within it, and did not include a recitation that the seller owned the property. A map was sufficient in Dixon v. Amoco Production Co.,12 because it included names of surveys, General Land Office Abstract Numbers, names of owners in the chain of title, acreage amounts in each tract, survey lines for each tract and the lessors of oil, gas and mineral leases covering each tract.

10 Stekoll Petroleum Co. v. Hamilton, 255 S.W.2d 187, 192 (Tex. 1953); Wilson v. Fisher, 188 S.W.2d 150, 152 (Tex. 1945).

If a participant owns non-producing land or lease interests located within the geographic parameters of an exploration area, the participant typically contributes such interests to the project. The participant contributing the land or lease interests is generally reimbursed by the other participants for all acquisition costs except for its own proportionate share of the costs in exchange for the other participants obtaining an interest in the acreage. It is important for the parties to spell out in the participation agreement exactly what land interests are being contributed and at what reimbursement expense. The contributing participant is typically reimbursed for such expenses as lease bonuses, title costs and landman expenses. An example of a definition of “Lease Acquisition Costs” for which a contributing participant will be reimbursed is “with respect to any Lease, the sum of (i) all direct out of pocket consideration paid to lease brokers, landmen, geologists and engineers in connection with the acquisition of such Lease, including without limitation, any incentive overriding royalty interests or participations assigned to lease brokers, landmen, geologists and engineers, and (ii) all direct out of pocket costs incurred in the acquisition of such Lease.” Depending on the business deal, the contributing participant may also be paid a per acreage bonus or retain an override in the acreage as further compensation for its efforts in assembling the acreage.

If a participant holds interests in existing wells located within the exploration area, the parties need to determine whether or not the wells will be included in the project. If so, the other participants will need to purchase their respective interests in the wells. The acquisition of such interests is often addressed in a separate purchase and sale agreement. If the wells are not to be included in the project, the participation agreement needs to expressly exclude the applicable wells.

When describing an existing well to be excluded, it is preferable to describe both the wellbore itself and a certain amount of acreage surrounding the well, if only for regulatory purposes. The acreage included may be the drilling or spacing unit that is approved by the applicable state agency. If there is not a state approved drilling or spacing unit, the parties may describe the acreage as a square or a circle around the well. The parties
need to address what surface area the party that holds the interests in the existing wells will retain for future facilities, such as tanks, flow lines and treatment equipment. Thought needs to be given as to whether or not the reservation is to only producing formations or all depths.

In Petro Pro Ltd. v. Upland Resources, Inc., the Amarillo Court of Appeals interpreted an assignment covering rights in a particular wellbore, with no discussion of any depth limitation. Applying canons of interpretation, the court rejected the assignor’s argument that the assignment was limited to the producing horizon at the time of the grant, and held that “the vertical limit of the assignments is defined by the depth of the wellbore as assigned.” Therefore, the assignment will not extend below the depth of the well at the time of assignment, but shallower horizons that were not producing at the time of the assignment may also be included. In light of this situation the parties to a development agreement would be wise to specify the depth limitations, or lack thereof, in any well reservation.

A party reserving interests in existing wellbores may result in unintended consequences. The party needs to consider whether or not such a reservation will violate any maintenance of uniform interest provisions contained in operating agreements applicable to the contributed acreage.


The participants’ interests in the exploration area need to be specified within the document. The parties often prefer to set out the interests in a schedule to the agreement that can be updated. The interests can vary depending on the parties’ participation in prospect areas and initial wells within prospect areas. Exploration and development costs are typically shared by the participants based on their participating interests in the exploration area.

It is not unusual, however, for one party, generally the party who originated the idea of the project or who has acquired initial acreage in the exploration area, to receive a carried interest as part of its compensation for

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14 Id. at 751.
its efforts in forming the project. In such an instance, one party is paying for some portion of another party’s costs in the area, a “carried interest,” and the participation agreement needs to specify all of the terms of the carry. The possible variations of a carry are virtually limitless. This chapter does not attempt to address many possible variations but merely raises some points to be considered.

The parties to a participation agreement need to specify whether the carry is to the casing point\(^{15}\) or is the party being carried to completion, including equipping to the tanks, \(i.e.,\) all flow lines and meters? The parties also need to specify whether or not the carry will apply to lease acquisition costs or only to the costs of drilling and completion of wells. The percentage of the carry needs to be specified. If the carry is for a certain number of wells, rather than a set amount of carry, the carried party will want to include specific provisions that in the event a carried well is not completed as a producing well, the carried party will be carried in a substitute well. A party may agree to carry a certain percentage of another party’s interest up to an aggregate amount\(^{16}\). The carried amount may be an aggregate amount that can be utilized at anytime during the term of the exploration agreement or can be an amount that must be used within a certain period of time or lost\(^{17}\). If the carry is for a particular amount, the participation agreement

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\(^{15}\) “Casing point” refers to the time when a well has been drilled to the objective depth stated in an initial notice, appropriate tests have been made, and the operator has notified the drilling parties of his recommendation with respect to the running and setting of a production string of casing and completing the well. Rocky Mountain Joint Operating Agreement Form 3, November 1959, Section 9.4 Treatise § 920.5.

\(^{16}\) See Section 4.3 of the E&D Form for sample language regarding a carry amount.

\(^{17}\) The following is an example of a carry that must be used within a certain period of time or is lost:

“During the Obligation Period, for any Well in which the Carried Party elects, or has elected as of the Closing Date, to participate prior to total expenditure of the Carry Amount (“Promoted Well”), the Promoted Holder hereby promises and agrees to be responsible for and pay on a current and timely basis seventy-five percent (75%) of the Carried Party's Working Interest Share of all Well Costs (“Promoted Well Costs”) for such Well. To the extent the Promoted Holder is participating in such Well, the Promoted Holder shall also pay the Promoted...
needs to provide that the parties have an obligation to maintain records of the amount of carry paid and a right to audit such records.

In situations involving carried interests, the party paying for the carried interest may be limited in its ability to deduct intangible drilling and development costs to that percentage which equals its permanent working interest percentage in the applicable well. This potentially adverse result

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Holder’s Working Interest share of Well Costs for such Well. Notwithstanding anything contained in this Agreement to the contrary, the Promoted Holder’s obligation to pay Promoted Well Costs in any given Year or during the Post-Carry Period shall terminate at such time as the aggregate Promoted Well Costs paid by the Promoted Holders during all periods equals the Carry Amount.

With respect to Year 1, Year 2 and Year 3, any unspent portion of the applicable Unadjusted Carry Amount Tranche for any such Year shall, up to an amount not to exceed twenty-five percent (25%) of such Unadjusted Carry Amount Tranche, be carried forward to the next Year and shall serve to adjust upward the applicable Unadjusted Carry Amount Tranche for such next Year (but not any succeeding Year) by such carried forward amount. When determining how much of an Adjusted Carry Amount Tranche is spent during a Year, Promoted Well Costs shall first be applied to reduce the portion, if any, of the prior Year’s Unadjusted Carry Amount Tranche carried forward to the current Year, and shall then be applied to the current Unadjusted Carry Amount Tranche. With respect to Year 4, any amount of the Unadjusted Carry Amount Tranche for such Year that is not spent in such Year may, up to an amount equal to twenty-five percent (25%) of such Unadjusted Carry Amount Tranche, be carried forward to the Post-Carry Period and applied to Promoted Well Costs incurred prior to the expiration of the Post-Carry Period. Upon the earlier to occur of the expiration of the Post-Carry Period and the expenditure of the Carry Amount (as may have been reduced pursuant to this Section), the Promoted Holder’s carry obligations under this Section 3 shall terminate in their entirety. Any unused portion of the Carry Amount shall automatically expire. For the avoidance of doubt, (i) any portion of a Year’s Unadjusted Carry Amount Tranche that is carried forward to the next period and not used during such next period shall automatically expire at the end of such next period and reduce the Unadjusted Carry Amount and (ii) with the exception of the potential twenty-five percent (25%) carry forward described above, any portion of a Year’s Unadjusted Carry Amount Tranche that is not used during such Year shall automatically expire at the end of such Year and reduce the Carry Amount. If, during Year 1, Year 2 or Year 3, as applicable, the Promoted Holder pays Promoted Well Costs in excess of the Carry Amount Tranche for Year 1 or the Adjusted Carry Amount Tranche for Year 2 or Year 3, the Unadjusted Carry Amount Tranche for the next Year shall be adjusted downward in an amount equal to the amount of such excess Promoted Well Costs from the current Year.”

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may be avoided if the parties elect to treat their arrangement as a partnership for tax purposes. The parties must make an affirmative election in the participation agreement to have the arrangement treated as a tax partnership. If a tax partnership is elected, the same election should also be made in the joint operating agreement that governs the prospect area or exploration area.

In some instances, a party carries another party’s interest but then receives a larger percentage of the revenue until it has recouped the amount it paid on the other party’s behalf (a “back-in-interest”). The carried party then obtains a larger net revenue interest once the other party has recouped its costs. If a payout is contemplated, the agreement must clearly set forth the method for calculating payout. The parties should also agree to provide reports showing the revenue received on a periodic basis, such as a monthly or quarterly basis, and a cumulative status of payout. If the parties have before payout and after payout interests, those interests should be expressly set forth in the participation agreement.


After the parties determine the exploration area, the parties engage in securing information to identify prospects within the exploration area. Seismic is important to the development of a property. If one party owns proprietary seismic data covering any portion of the exploration area, the party can either sell the other participants an ownership interest in the data or license the data to the other parties for the term of the exploration agreement.

If none of the parties owns seismic data covering the exploration area, the parties need to address how they will acquire seismic data. The participation agreement should set forth how the parties will decide on the scope of the seismic survey, i.e., the participation agreement can either set forth a defined area to be covered by the seismic survey, or the area to be covered by seismic survey can be determined by the parties from time

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to time during the term of the exploration agreement. The parties also need to decide which participant will have the authority to negotiate and sign a contract with the company conducting the seismic survey. Parties generally desire to have a license in newly acquired data for which they have contributed funds. A separate license will permit each participant the right to receive copies of and use the data. If only one party can be named as the licensor, the operator of the project is generally named. If multiple licenses are not available, the parties should have the right to review the seismic data at the operator’s offices during normal business hours.20

If the parties are acquiring seismic, the participants may want to establish a budget for such acquisition. The participants generally share the cost of the seismic in proportion to their interests in the contract area, and they do not have a right to elect not to participate. In participation agreements covering very large contract areas, the agreement may provide for several separate prospect areas and that the parties can elect whether or not to participate in the acquisition of seismic data on a prospect by prospect basis. If one party does not want to participate in the acquisition of seismic of a prospect area, then it will typically be out of the prospect area covered by the seismic. The participation agreement also should designate who will process and interpret the seismic. Other issues that the parties may want to address in the participation agreement include which method will be utilized to process the data and how long the confidentiality provisions will apply. Typically, the confidentiality provisions include certain exceptions to

20 Sample language is as follows: “With respect to any Geoscientific Data acquired after the date hereof, Operator will give notice to all Parties that it is acquiring such Geoscientific Data and upon notice, assist any Party in its efforts to be named as a licensee; provided that if, notwithstanding such assistance, under the terms of the applicable license or agreement (except to the extent a Party has acquired a license therefor), only one Person can be named as licensee, Operator will be named as licensee. No Party other than Operator will have any rights of ownership in any Geoscientific Data that is non-transferable under the terms of the applicable license or agreement; provided, however, that, to the extent not expressly prohibited by the terms of the applicable license or agreement, each such other Party shall be entitled, after reasonable notice to Operator, to review such Geoscientific Data and material during normal business hours in Operator’s offices.”
permit the disclosure of the data to the parties’ consultants and to potential purchasers or investors, provided that each third party who receives the data is subject to the limitation on further disclosures. Given that a sale of seismic data by one of the parties during the term of the participation agreement could reduce the value of the project for another party, the parties should address any restrictions on the ownership and transfer of the data.21

Once data is acquired and processed, generally each of the participants who has paid all of its proportionate share of the data acquisition costs is provided a copy of the data (or access to the information at the operator’s offices) for its review and analysis. The participation agreement needs to specify how the data will be interpreted for purposes of identifying prospects that appear favorable for oil and gas drilling and production. Either one of the participants is given the responsibility for identifying prospect areas or the agreement will provide a method for the participants to discuss the interpretation of the data and identification of the prospects. If the participants will jointly determine prospect areas, the participation agreement needs to establish voting procedures.


If the participants are going to jointly acquire seismic data covering the exploration area, the process of lease and land acquisition may begin before the acquisition of the data or, if a participant owns data, the process of lease and land acquisition may not commence until after the identification of prospect areas. Participants need to be careful that they are not competing with each other in acquiring leases within the exploration area. If all of the participants have the right to acquire leases, the parties need to frequently communicate with each other regarding their leasing activities. Participants often find it easier to delegate the primary responsibility for leasing to one participant.22 If one party has already acquired acreage within the prospect

22 See Section 6.1 of the E&D Form for sample language providing that one party has the primary responsibility for the acquisition of leases.
area, it may have established a network of contacts within the area that will be beneficial in the future acquisition of acreage and is, therefore, the logical choice to be the participant charged with the primary responsibility of obtaining additional acreage.

If another participant locates an opportunity within the exploration area, the participant should provide the information to the party named to manage the leasing process and let that party pursue the opportunity. Participation agreements typically include area of mutual interest (described in greater detail in Section 10.05 of this chapter) provisions. In the event that, notwithstanding the fact that one party has primary responsibility for leasing, another participant obtains a lease within the exploration areas, because of the area of mutual interest provisions, the participant who obtained the lease will be obligated to offer each other participant its proportionate share of such lease.

The participants obviously do not want to give another participant a blank check to acquire leases. Some participation agreements include provisions setting limitations on the amount of bonuses, royalties, and overriding royalties that can be paid. The parties may want to establish a budget for the acquisition of lands and leases. The level of detail of the budget will vary depending on how much authority the participants are willing to delegate to the acquiring party. The participation agreement should also provide whether or not the acquiring party can exceed the budget and, if so, by how much before having to obtain the consent of the other participants. If the acquiring party greatly exceeds the budget, will there be any consequences? For example, the acquiring party may automatically forfeit primary responsibility for acquisition of leases if it exceeds the budget without the participants’ consent.

Each of the participants should be responsible for the payment of its proportionate share of the lease costs. Reimbursable lease costs typically

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23 The following is an example of a limitation on the incentive overriding royalties: “Promoter shall have the right, as it deems necessary in its reasonable discretion, to assign to landmen, geologists and engineers an aggregate incentive ORRI of up to 2.5% of 8/8th (the ‘Incentive ORRIs’) on any Lease acquired within the Contract Lands.”
include costs of verifying title. Parties, sometimes, however, put limits on
the amounts that will be reimbursed if the costs are being paid to an affiliate
of the acquiring participant. It is not uncommon for the landmen who are
involved in the acquisition of leases to receive incentive overriding royalties
for their efforts. The participation agreement needs to specify that all parties
who participate in the leases will share in the burden of such overriding
royalties.

The agreement needs to specify when the acquiring party will assign
interests in leases to the participating parties. It is not uncommon for a
company that is acquiring leases to obtain the leases in the name of a
landman to delay third parties from finding out which industry participant
is acquiring acreage in the hope of avoiding a run-up in the acquisition costs.
The participant acquiring the leases often wants to limit administrative
costs and time relating to assignments and, therefore, prefers not to be
required to deliver assignments to the other participants on a lease-by-lease
basis. A delay by the acquiring participant to assign interests in leases
to the other participants, however, results in the other participants having
some bankruptcy risk. If the acquiring party were to file, or be forced into,
bankruptcy, the other participants will have only a beneficial interest in the
leases that have not yet been assigned to the participants. The leases will
be included in the bankruptcy estate of the acquiring party, and the other
participants must file a claim in the bankruptcy proceeding to obtain their
interests. The circuits are split as to whether the Bankruptcy Code’s safe

24 Sample language is as follows: “. . . provided, however, ‘Lease Acquisition Costs’ shall
in no event include any amounts owed or paid to any Party hereto or any Affiliate of any
Party hereto other than the Existing Entities so long as each such Lease with any Existing
Entity reflects the Promoter’s good faith effort to lease the lands covered thereby on terms
substantially similar to those that would reasonably be available in the area at the time such
Lease is executed in an arm’s-length dealing with a Person other than any Existing Entity,
or Affiliate of Promoter.”

25 Having one party hold title to the leases is also beneficial when the participants have
not yet made their elections regarding participation in a prospect area or initial well because
it avoids a series of reconveyances in the event a party ultimately decides not to participate
in the applicable prospect area or initial well.
harbor for equitable title will prevail over the ability of a trustee to cut off the claims of the holders of unrecorded interests. However, regardless of which interpretation applies the holder of the equitable interest in the leases is materially worse off than would have been the case had the insolvent party made the assignments.

To address the competing interests of the participants in assignments of the leases, participation agreements should set forth a clear schedule of when assignments will be delivered. For the participants that are acquiring interests in leases obtained by another participant, the ideal delivery schedule is concurrently with the participants’ payment of their proportionate share of the lease acquisition costs. It is not unusual, however, for an exploration agreement to provide that assignments of interests in the leases will be delivered on a periodic basis, say for example, on a quarterly basis.

If assignments are being delivered on a periodic basis, it is advisable to also address the earlier delivery of assignments for significant acquisitions, for example, in connection with any acquisition for which the lease acquisition costs will exceed $1,000,000, each participant who pays its proportionate share of the lease acquisition costs will obtain an assignment of its interest at the time of the acquisition. In addition, if there is quite a bit of leasing activity in any month, say for example, the aggregate amount of lease acquisition costs incurred in a month exceeds $500,000, the acquiring participant will deliver each participant an assignment of its interest in such leases within a certain period of time (for example, fifteen days) after the end of such month.

27 See Section 6.6 of the E&D Form for a provision addressing the assignment of subsequently acquired interests.
28 A sample of such language is as follows: “In the event the aggregate Lease Acquisition Costs for any Lease exceeds $1,000,000.00, concurrently with the Acquiring Party’s acquisition of such Lease, the Acquiring Party shall execute and deliver an Assignment to each Non-Acquiring Party that has paid, or concurrently with such acquisition pays, its Proportionate Share of the total Lease Acquisition Costs for such Lease.”
The form of assignment should be attached to the participation agreement to avoid future disputes. Typically, the form of assignment provides for a special warranty of title by the acquiring participant, i.e., that there are no defects of title “by, through or under” the assignor.


If the exploration area is large, the participants may want to provide a mechanism for designating separate prospect areas. A prospect area is typically proposed by one participant and then each participant has the election of whether or not to participate within the prospect area. A participation agreement should set out general parameters of a prospect area, such as the maximum number of acres that can be included in a prospect area, for example, “each prospect area shall not in any event exceed 1280 contiguous acres.” The participation agreement may provide either that only one party may propose prospect areas (generally the party named as operator) or that any party may propose prospect areas.

The participation agreement should set forth any information that is required to be included in a proposal for a prospect area. Such required information typically includes a description of the proposed prospect area and any seismic data that covers the prospect area. Although participants may want to include a general statement that the participants can also request such additional information as they may reasonably request, care should be taken to establish a definitive period of time allotted to making an election to participate in a prospect area. For example, the non-proposing party should have thirty days from the date it receives an initial proposal to make its election of whether or not it will participate in the prospect area. The clock should start running upon the delivery of the information that is expressly specified in the participation agreement. The proposing party can provide additional information as requested by a non-proposing party, but the delivery of such information should not suspend the time period for making an election. To do otherwise, could give the non-proposing party an opportunity to indefinitely delay having to make an election regarding a proposed prospect area as the party continues to “reasonably request additional information.”
If a participant does not approve a proposed prospect area, that participant should suggest an alternative prospect area. The alternative prospect area then should be presented to the other participants and the proposals submitted to a vote based on the participation interest of each party. The participation agreement needs to specify what will happen in the event there is a tie in the votes. One solution is for the operator to have the final say in the designation of the prospect area. Other alternatives are to allow the participants who agree on the prospect area to proceed with exploration and development of the prospect area or for the participation agreement to provide that the designation of the prospect area is to be submitted for arbitration. If arbitration is selected, the participation agreement should provide for express time periods for the commencement and resolution of the issue.

In some circumstances, prospect areas may overlap. The participation agreement should address what the effect will be if a party has participated in one prospect area but not another that overlaps it. Issues will include: How will the costs and revenues be shared? How will wells be allocated between the prospect areas?


Will each party be entitled to propose the initial well in a prospect area or will only one participant (generally the participant acting as operator) have the right to make development proposals? The participation agreement should set forth in some detail the procedures for proposing an initial well and the parties’ election whether or not to participate in the initial well.

Any required information for a well proposal should be specified in the participation agreement. Such information typically includes an authority for expenditure for the well, a sketch showing the location of the proposed well, together with the geologic information, prospective feature and any interpretative data or other maps upon which the proposed well is based, if any. Each participant has a certain period of time after receipt of a well proposal, typically thirty days, to elect to participate in the initial well. The participation agreement should provide that any election to participate must be made in writing and that a failure by a party to deliver a written election
within such period of time will constitute an election by such party not to participate in the initial well. The parties should also specify whether a participant's election to participate in an initial well is solely by providing written notice or if the participant must also pay a portion, or all, of its proportionate share of the estimated cost of the proposed development at the time it makes its election.

If one or more of the participants has greater financial strength than the other participants, the participants may want the agreement to limit the number of well proposals or prospect area proposals that can be outstanding at any given time. The inclusion of such limitations helps prevent the less financially strong participants from being forced to elect not to participate in a prospect area if the stronger participant becomes aggressive in its drilling program. Limitations applied on a prospect-by-prospect basis, however, do little to prevent a party from getting drilled out of a project that has numerous prospect areas. For example, a limitation on drilling one well at a time per prospect area will not be much help to a participant if the participation agreement provides that there can be eight or nine prospect areas in development at any one time, which could result in eight or nine initial wells being drilled at any one time.

As an alternative to limiting the number of wells or prospect area proposals, another way to provide protection to the participants is to allow participants to farm-out all or some portion of their interest in a well or prospect area. The participants should be allowed to farm-out their interest to either another participant or to a third party. Typically, if the participant has the right to farm-out to a third party, there is an obligation that the participant first offer the interest being farmed-out to the other participants in the project. The participant farming-out its interest generally retains a small overriding royalty interest.

[8] — Consequences of a Failure to Participate.

Typically all parties to a participation agreement are required to participate in the initial planned development, whether it is the first well in the exploration area or the first well in a prospect area. The rationale is that each party needs to exhibit some level of commitment to the project.
The penalties for not participating in a proposal under a participation agreement are often much harsher than the typical production penalties imposed upon a “Non-Consenting Party” under an American Association of Professional Landmen (AAPL) model form operating agreement. The point of providing penalties for non-participating parties is to prevent a party from profiting from the development without sharing the risk, but yet maintain the overall objectives that the parties had when entering into the participation agreement.

The consequences of failing to participate in a prospect area or the drilling of a test well will vary greatly among participation agreements. The consequences need to provide adequate incentive for the parties to perform as promised in the participation agreement and to be designed in such a manner as to help fulfill the participants’ business objectives. The consequences will probably vary depending on the activity or operation in which a party elects not to participate. For example, the failure to participate in the first well in a prospect area and the failure to participate in the acquisition of subsequently acquired interests in the Area of Mutual Interest (AMI) have very different levels of risks for the parties.

If the exploration area is fairly small, a party who fails to participate in the initial operation may find itself out of any future operations under the agreement. A non-participating party may be required to forfeit its interest in the leases within the exploration area without compensation. Although forfeiture provisions are often included in participation agreements, care must be taken that forfeiture is a reasonable penalty for a party’s failure to participate.

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29 Joint Operating Agreements are discussed in greater detail in Section IV of this chapter.

30 An example of such a provision is: “If a Party elects not to participate (or is deemed to have elected not to participate) in the drilling or the completion of the Initial Exploratory Well, such Party shall relinquish, surrender and assign all of the interest acquired by such Party under the terms hereof, including all of its right, title and interest in the Initial Exploratory Well and all of the Contract Lands (including its right to participate in the acquisition of Leases within the Contract Lands), proportionately, to the Parties participating in such operation.” See also Sections 4.3 and 4.4 of the E&D Form for examples of forfeiture language.
participate.31 If a court finds that forfeiture is too harsh a remedy, the parties may be less satisfied with the judicially imposed remedy than if they would have originally agreed upon a more reasonable penalty.

A party that forfeits its interest in a prospect area should also forfeit its rights in the area of mutual interest related to the applicable prospect area and should be bound by a non-compete provision for some period of time. Under a non-compete provision, the forfeiting party and its affiliates would be prohibited from acquiring an interest in the prospect area. The non-participating party should also forfeit its right to review the seismic data covering the prospect area in which the party is not participating.

In addition to forfeiture provisions, some agreements provide that the non-participating party owes liquidated damages to the other parties.32 Liquidated damages may be appropriate if the parties have a limited period of time to commence drilling and the failure of a participant to perform as anticipated will cause the other parties significant hardship in completing the operation in a timely manner. Liquidated damages also may help compensate the other participants for having to search to find another industry player to fill the role of the breaching participant.

In other participation agreements, a failure to participate, even in the initial well drilled under the participation agreement, may not be cause for the non-participating party to be excluded from all future operations. The

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31  4 Williams & Meyers, Oil and Gas Law §681.2 (2008)(“In view of the judicial antipathy to forfeiture it may be expected that a court will be ready to find that such grounds [for forfeiture] have not occurred.); Richardson, Steven B. and Robinson, Peter D., “Comprehensive Oil and Gas Exploration Agreement,” Oil & Gas Agreements: The Exploration Phase Institute, Paper 9 (Rocky Mt. Min. L. Fdn. 2010).
32  “In the event Participant fails to participate in the drilling of either or both of the Obligation Wells, then in addition to relinquishing its rights and interests in certain parts of the Project AMI as herein provided, Participant shall be obligated to pay and does hereby agree to pay to the Promoter the sum of US$550,000 as liquidated damages, and not as a penalty, for its failure to participate in the Obligation Wells. For the avoidance of doubt, the liquidated damages hereunder shall be the sole and exclusive remedy allowed to Promoter no matter what the actual damages are with respect to Participant’s failure to participate in either or both of Obligation Wells.”
defaulting participant may instead be excluded from participation in a certain number of future wells or prospect areas, say for example the next five wells, before it will again have the opportunity to participate in operations. The exclusion of a non-participating party from a certain number of wells prevents the defaulting participant from picking and choosing wells in which it participates based on the success of a prior well.

9 — Subsequent Operations.

Subsequent operations are typically governed by the applicable joint operating agreement. The joint operating agreement sets forth the mechanism for proposing and participating in subsequent operations and any penalties incurred by a co-participant who fails to participate in a subsequent operation. The AAPL form joint operating agreements provide that a non-consenting party in a subsequent operation does not participate in the revenues from the operation until the consenting parties have received revenues equal to their costs in the operations plus some percentage over such costs. The non-consent penalties provided for in joint operating agreements typically range from 100 percent for newly acquired surface equipment and cost of operation of the well to 500 percent for the costs and expenses of drilling, reworking, sidetracking, deepening, plugging back, completing and recompleting.33

As an alternative to allowing the joint operating agreement provide the consequences for a failure to participate in subsequent operations, the participation agreement may provide that a non-participating party will be required to relinquish its entire interest in the prospect area less the interests relating to the initial well (assuming the non-participating party participated in the initial well in the prospect area) and a certain amount of acreage surrounding the initial well in the prospect area. Another alternative is for the non-participating party to be deemed to have farmed out its interests in the subsequent well and a certain amount of surrounding acreage. The party farming out its interest typically reserves a small overriding royalty.34

33 AAPL Form 610 - Model Form Operating Agreement – 1989, Article VI.B.2(b).
34 Such farmouts typically cover the drilling and spacing proration or geological unit applicable to the subject well to the extent it covers the target zone and all uphole zones.

To ensure the prompt development of an exploration area and reduce the risk of the leases terminating for a failure to timely develop, the participants may agree upon a plan of development. In some instances, the development plan may be as simple as setting forth the order in which planned wells will be drilled. In participation agreements covering substantial amounts of acreage, the development plan may be much more complex. Separate development plans may be established for each separate prospect area within the exploration area. A development plan typically is limited to a certain period of time, say for example, one year, and sets forth the participants’ intentions regarding drilling to be conducted during that period. As reality may not always match the parties’ original expectations, the agreement should set out in some detail how the parties can modify the plan.

In some instances, the development plan may require one party to meet certain milestones. For example, three wells must be completed within the target zone on or before the first annual anniversary date of the participation agreement. A failure to meet the milestone may have consequences for the defaulting party. For example, if the party who is obligated to meet the milestones is acting as operator, a failure to meet the milestones may result in another party having the right to assume operations. Another example of a consequence for a failure to meet a milestone is that, if the defaulting participant’s interest is being carried by another participant, the amount of the carry is decreased. A failure to meet milestones may also give the parties the right to terminate the participation agreement if parties holding a majority of the participation interests vote for termination.


Participants typically name one of the participants (or an affiliate of a participant) as the operator for the exploration area. The party named as operator is also often named as the party with primary responsibility for lease acquisition and making development proposals. A participant whose interests are being carried by another participant may not be the best choice for operator because it does not share the same concerns regarding cost of operations as the other parties.
In some instances, a non-operator may have the right to assume operations pursuant to the participation agreement. If the agreement sets forth certain milestones that the operator is required to meet and the operator fails to meet those milestones, another participant may have the option to assume operations in either the applicable prospect area or in the entire exploration area. Such provisions are obviously more stringent than provisions in joint operating agreements that provide an operator can be removed only for good cause, but often make sense in the context of a participation because of the parties’ intention to develop the exploration area. Participants establish development plans to meet certain business objectives. If an operator is unable or unwilling to maintain a development plan, the business objectives of the participants will not be met. Another participant may be better able to achieve the results desired by the parties; thus, having the ability to remove an operator under a participation agreement at a time an operator could not be removed under a joint operating agreement may be appropriate.

The participation agreement needs to take into account that some prospect areas may already be subject to existing joint operating agreements with third parties (a “third party JOA”) who are not parties to the participation agreement. In such event, the existing third party JOA will continue to govern the prospect area. The parties to the participation agreement should agree, however, that they will vote for the participant named as operator in the participation agreement in the event the existing operator under the third party JOA is ever removed or resigns. If a third party JOA governs a prospect area, the participation agreement should

35 See Section 4.2 of the E&D Form for sample language in which, upon the operator’s failure to drill wells in accordance with a plan of development, the non-operator is entitled to assume operations for the wells contemplated by the plan of development, but only to the point when first production is obtained from the wells.

36 Good cause is defined in AAPL 1989 model form operating agreement as gross negligence or willful misconduct, the operator’s material breach of or inability to meet the standards of operation, or the operator’s material failure or inability to perform its obligations. AAPL Form 610 – Model Form Operating Agreement – 1989, Article V.A.1(b)1.
provide that in the event the parties to the participation agreement acquire all interests in the contract area, as described in such third party JOA, the parties will terminate the existing third party JOA and that the applicable area will thereafter be governed by an operating agreement agreed to by the parties and naming the applicable participant as operator.37

If the exploration area is not very large, the parties may elect to have the entire exploration area governed by one operating agreement. A joint operating agreement, however, that governs a large exploration area will make it difficult in the future to sell portions of the project. For larger exploration areas, therefore, the parties typically provide that each prospect area will be governed by a separate operating agreement. The form of operating agreement should be agreed to by the parties at the time of entering into the participation agreement and should be attached to the participation agreement as an exhibit.


A participation agreement may provide for certain financial assurances to the operator. Financial assurances can be as extensive as the operator’s imagination and the participants’ willingness to cooperate allow. An operator may have the right to receive prepayment for proposed operations.

The operator may have the right to require prepayment for operations to be conducted within the next thirty-, sixty- or ninety-day period. If funds are advanced to the operator, the participation agreement should expressly provide that the funds cannot be commingled with other funds of the operator. The agreement should also provide that the operator holds the funds in trust until it applies the funds to the applicable operation under the participation agreement. Any excess funds held by the operator should be used to reduce the amount of any subsequent advance requested by the operator.

37 An example of such a provision is as follows: “In the event that any Jointly Owned Leases within the AMI are subject to a Third Party JOA and two or more Parties jointly own all of the undivided working interests within the Contract Area of such Third Party JOA, the Parties shall promptly terminate such Third Party JOA and execute an Operating Agreement covering such Contract Area.”
Some participation agreements provide that an operator may have the right to require participants to post a letter of credit for their proportionate share of the cost of anticipated operations. Some operators have requested letters of credit in amounts sufficient to pay for an entire year of proposed operations. Such assurances are obviously beneficial to the operator but can be very detrimental to the non-operators who must obtain letters of credit, generally by accessing their credit facilities.

Delinquent payments will generally accrue interest. The rates vary, but parties often provide for interest to accrue at the highest lawful rate. In addition to being obligated to pay interest on its delinquent payments, a defaulting party will often forfeit rights under the participation agreement until the party brings the payments current.

The defaulting party may be denied access to the wells. The operator may also have no obligation to deliver records or reports to the defaulting party until such time as the party is no longer in payment default. In the oil and gas industry, operators often offset past due amounts owed to them by non-operators against revenues received, but the AAPL form joint operating agreements do not include a right of offset. To provide for a contractual right of offset (rather than relying solely on any common law right of offset), the parties should include a provision in either the participation agreement or related joint operating agreement pursuant to which each participant grants the operator a right of offset.

Some participation agreements provide for a grant of a lien by each of the parties to the others to secure their obligations under the agreement. To perfect the lien, the parties will need to record a memorandum of the agreement in the real property records describing the assets covered by the grant of the lien. If the parties also grant a security interest in the personal property subject to the participation agreement, the parties will need to record financing statements in the appropriate filing office pursuant to the Uniform Commercial Code.38

38 Article 9, § 310 of the Uniform Commercial Code requires filing a financing statement in the appropriate office to perfect a security interest in personal property in most cases.
[13] — **Standard of Performance.**

The participation agreement should set forth a standard of performance for parties that have duties under the agreement, such as the duty to acquire leases or seismic data. The standard of performance should be consistent with the standard set forth in the operating agreement. Typically the participants providing services will be required to provide their services with due diligence and dispatch, and in a good and workmanlike manner. Participants providing services generally desire to limit their liability and include disclaimers of their liability, except for liability arising out of their gross negligence or willful misconduct. A participant desiring to so limit its liability needs to have the limitation written in such a way as to be enforceable under applicable state law. If an exculpatory clause will protect a participant from its own negligence, many states require that the intent be conspicuous. In agreements governed by Texas laws, such exculpatory clauses are typically printed in bold face and capital letters. 39

[14] — **Management Committee.**

Similar to the management of a joint venture, the participants to a participation agreement may elect to form a management committee. Management committees are particularly useful when the exploration area is large and the parties need to agree upon development plans to

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Article 9, §§ 301 to 306 of the Uniform Commercial Code govern the applicable law for perfection and priority of security interests in personal property. Section 9.307 of the Uniform Commercial Code determines the location of the debtor for choice-of-law purposes.

39 The following is an example of a disclaimer: “Without expanding any obligations which Operator may have to the other Parties, it is expressly agreed that Operator shall never have any liability to the other Parties with respect to operations of the properties subject to this Agreement greater than that which it might have as the operator to a non-operator under the applicable Operating Agreement (or in the absence of such an agreement, under the AAPL 610 (1989 Revision) form Operating Agreement), AND AS AN OPERATOR OR NON-OPERATOR SHALL NOT BE RESPONSIBLE TO THE OTHER PARTIES FOR OPERATOR’S NEGLIGENCE, AND EACH OTHER PARTY ACKNOWLEDGES THAT OPERATOR HAS NO RESPONSIBILITY FOR OPERATOR’S ACTIONS TO THE OTHER PARTIES OTHER THAN FOR GROSS NEGLIGENCE OR WILLFUL MISCONDUCT.”

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ensure proper development of the area.\textsuperscript{40} The makeup of the management committee is up to the participants. Each participant may be permitted to appoint an equal number of members to the committee or the number of members each participant may appoint may be determined based on a participant’s participating interest in the exploration area. The parties should give some thought as to the make-up of the management committee in the event a participant sells only a portion of its interest in the exploration area. Should a subsequent participant that holds less than a certain percentage of ownership in the exploration area not be entitled to a representation on the management committee? For example, if a participant who owns a forty percent interest in the exploration area sells an undivided ten percent interest to a third party, should that third party be entitled to representation on the management committee?

The participation agreement should specify a required number of scheduled meetings per year, along with a list of information that will be provided to each committee member prior to each scheduled meeting. Examples of information to be delivered include budgets, the operator’s drilling proposals, and a look back review of actual performance versus budgeted performance. Typically the non-operators will try to negotiate for a lengthy list of information to be delivered, including generic descriptions of materials, such as “other information reasonably requested.” Whereas the operator, because it is typically the party that is responsible for compiling information for the management committee meetings, prefers a limited, very specific list of information that must be delivered at the meetings.

Each participant should have the right to call special meetings of the management committee, provided that each other party is given sufficient advance written notice of the meeting, for example, two weeks advance notice. The number of special meetings that may be called by any party within a year should be limited, typically to no more than two meetings per year.

\textsuperscript{40} See Section 5.3 of the E&D Form for language regarding the formation and responsibilities of an operating committee.
If there is a possibility that participants will each hold fifty percent (50%) of the voting power, the participation agreement should address what will happen if the management committee has a deadlock. In some instances, the party acting as operator will have the deciding vote. In other instances, the parties agree that a dispute will be sent to an outside consultant, whose decision will be binding on all parties. Some issues may be sent to dispute resolution. Regarding a dispute over whether or not the parties will proceed with a proposed development plan area, the proper method of dispute resolution may be to allow the parties wanting to proceed with the plan to have the right to adopt and execute the development plan on their own. In such a case, the participation agreement should have provisions addressing the potential of the parties being involved in multiple development plans at any one time.


The participation agreement needs to address the payment of delay rentals, shut-in payments and minimum royalties. One of the participants (the “designated participant”), typically the participant named as operator, is delegated the responsibility for the payment of delay rentals, shut-in payments and minimum royalties. Given that the designated participant will not want to bear the risk of another participant not paying its proportionate share of the delay rentals or other lease payments, participation agreements generally provide that the designated participant will send written notice to the other participants that delay rentals, shut-in payments or minimum royalties are coming due and the amount due at least sixty days prior to the required date of payment. The other participants are then required to pay their proportionate share of the delay rentals, shut-in payments or minimum royalties at least thirty days before such payments are to be made. Any party who fails to pay its proportionate share of such amounts no longer has an interest in the lease for which the payments are being made and is

41 See Section 5.5 of the E&D Form for sample language.
required to assign its interest in the lease to the other parties who pay their proportionate share of the applicable lease payments. If none of the parties elect to pay the applicable lease payments, the lease is no longer subject to the participation agreement.

[16] — Abandoned Wells.
If the operator of the prospect desires to plug and abandon a well that is subject to the participation agreement, the parties generally have the right to assume operations of the well. Once a well has been assigned to an assuming party, it is no longer subject to the terms of the participation agreement or related operating agreement.

A participation agreement typically includes some standard representations. The parties each represent that they are a legally formed entity and in good standing and existence in their state of organization. Each party also typically represents that upon execution and delivery of the agreement, the agreement will be a legally valid and enforceable agreement, and that the execution and delivery of the agreement will not be in contravention of any material agreement, mortgage or other instrument to which the participant is bound. Similar to the no broker representation included in purchase and sale agreements, the parties also represent that they do not owe any fee to any broker for which the other participants will be liable. Another common representation is that each participant is not subject to any litigation that would prevent the participant from entering into the participation agreement or performing its obligations under the agreement.

If a participant is contributing acreage in the exploration area, the participation agreement may include representations relating to the property. Representations that are typically included in purchase and sale agreements may be applicable in such participation agreements. Representations include those addressing the existence of production or marketing agreements that cannot be terminated within a certain period of time, often sixty days. If one participant is going to act as operator, the parties may elect to include a representation that such participant holds the proper permits.
With respect to the contributed properties, the parties typically want representations regarding any outstanding commitments and any existing areas of mutual interest or tax partnerships to which the properties are subject. If the properties have ongoing operations, the parties may also include representations regarding those operations, such as representations that the contributing participant undertook proper environmental review when it acquired the property, that operations on the property have been conducted in compliance with environmental laws, and that royalties have been properly paid.

[18] — Disclaimers.

Treatment of the co-participants as joint venturers or partners may arise implicitly by operation of state or federal law. As such, it is advisable to expressly disclaim any such implicit treatment, to the extent the participants have not otherwise agreed (i.e., agreeing to be a partnership for tax purposes).42

[19] — Term and Termination.

The participation agreement should survive for a certain period of time. The term of a participation agreement is determined based on the exploration area and the period of time the parties anticipate that exploration and development will take. The agreement typically provides that the parties may elect to extend the period of the agreement so long as they elect to do so within a certain period of time before the end of the term.

The parties may want to provide for a right to terminate the agreement prior to the end of its term in the event the project is not successful. In some instances, the holders of a super-majority (sixty-six percent or greater) of

42 The following is an example of such disclaimers: “The Parties do not intend to create a partnership or fiduciary relationship by entering into this Agreement. The Parties intend, however, that pursuant to the provisions of Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code, the arrangement created under this Agreement is to be treated as a partnership for U.S. federal and state income tax purposes, and each Party agrees not to elect to be excluded from the applicable provisions of said Subchapter K. Therefore, the Parties agree to be governed by the Tax Partnership Agreement attached hereto as Exhibit A.”
the interests in the exploration area may have the right to terminate the agreement. The participation agreement may provide that the parties may terminate the agreement if certain milestones, such as acquiring a certain amount of acreage or completing a certain number of producing wells within a given period of time, are not met.

Although not often addressed, the parties may want to include provisions addressing what will happen to any uncompleted aspects of the project upon termination. For example, what will happen to the planned development in an incomplete prospect area? If the acreage has been acquired in a prospect area but the first well has not yet been drilled in the prospect area, will the parties remain obligated to participate in the test well? Will all development and operations on an incomplete prospect area automatically become governed by the applicable joint operating agreement?

§ 10.04. Joint Operating Agreement.

In addition to the participation agreement, participants enter into one or more joint operating agreements (each a “JOA”). The AAPL has published model forms of joint operating agreements since 1956. The forms commonly used in transactions today are the 1982 and 1989 model forms.

Some industry participants consider the 1982 form more pro-operator. They point to the fact that the 1989 AAPL form expands the operator’s standard of care, provides for automatic removal of an insolvent operator, and gives non-operators more extensive rights to inspect the books and operations as evidence that the 1982 form is more pro-operator. Many industry participants still use the 1982 form. However, the 1989 form has made certain improvements to the 1982 form, such as including standard lien provisions in which each party grants each other party a security interest in, and lien on, its interests in the contract area to secure such party’s obligations under the joint operating agreement. Parties typically add similar security

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43 *See* Article XII of the E&D Form for an example of provisions to govern the jointly owned acreage that is not covered by a JOA after the termination of the participation agreement.
interest and lien provisions to the 1982 form by including them in Article
XV, Other Provisions.

In preparing the JOA, the parties typically either strike Article VI.A of
the JOA, which addresses the initial well to be drilled on a contract area, or
reference the first well to be drilled pursuant to the participation agreement.
The parties should consider deleting the maintenance of uniform interest
provision from the JOA. This provision can have unintended consequences;
for example, all parties are required to consent to an assignment of only
certain depths within the contract area. Parties often also strike the
preferential right to purchase provision in the JOA because of its impact on
marketing and selling a party’s interest in the contract area.

The JOA must coordinate with the participation agreement. There will
be overlapping provisions between the JOA and the participation agreement.
Issues such as area of mutual interest, renewal of leases, well proposals,
consequences of electing not to participate in a proposed activity, and dispute
resolution will typically be addressed in both agreements. The parties need
to be careful that the provisions in each of the documents work together.
Common provisions, such as dispute resolution provisions, need to either
mirror each other exactly or the provisions in the participation agreement
need to be incorporated into the JOA by reference to the participation
agreement. Incorporation by reference is appropriate in those instances
where the incorporated provision will be in effect in both agreements
simultaneously. Given that a JOA will typically survive for a longer period
of time than the participation agreement, incorporation of a provision that
may terminate in the participation agreement prior to the termination of the
JOA is not appropriate.

One way to address the issue of conflicting provisions is to state that
a provision of the JOA is not effective until such time as the participation
agreement terminates. For example, each agreement will include area of
mutual interest provisions. The area of mutual interest in the participation
agreement will probably cover a larger area than that set forth in the JOA. To
avoid conflicting provisions, the area of mutual interest in the JOA does not
become effective until after termination of the participation agreement.

If, notwithstanding the parties’ best efforts, there is a conflict between
the JOA and the participation agreement, the parties should have specified
which agreement will govern in the event of a dispute. During the development phase of the project, the participation agreement will typically be the controlling document. The participation agreement typically sets forth in greater detail the intentions of the parties during the initial development of the project. Subsequent operations, such as the drilling of a second well in a prospect area, are generally governed by the JOA. The continued operations of the project area are also typically governed by the JOA and, therefore, the JOA should be the controlling document in disputes arising from such operations.

§ 10.05. Area of Mutual Interest.

A participation agreement generally establishes an area of mutual interest (an “AMI”). An AMI may not be necessary if one party will have the sole responsibility for acquiring all land interests within the exploration area. Nevertheless, the parties still typically provide for an AMI to provide a mechanism for dealing with interests acquired by participants who are not charged with the responsibility of obtaining leases. Exploration activities are generally conducted under a participation agreement with the purpose of acquiring additional oil and gas interests so any interests acquired should be acquired for the benefit of all the parties to the agreement.

An area of mutual interest obligates each participant (and generally each participant’s affiliates) to offer to the other participants the opportunity to acquire their respective proportionate share of any interest the party acquires in the AMI. The intent of an AMI is to prevent the participants from competing with each other for a superior position in the AMI.

An AMI in a participation agreement generally covers the same lands as the exploration area. As prospect areas are formed, separate AMIs are formed under the respective JOAs. The description of the area of mutual interest must be sufficient to satisfy the requirement of the statute of frauds.

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44 See Sections 5.2 and 13.1 and Article XII of the E&D Form for language addressing the interplay between the JOA and the participation agreement.
45 Article VI of the E&D Form contains sample AMI provisions.
The parties should establish a term for the survival of the AMI. A term is necessary to prevent the AMI from violating the Rule Against Perpetuities.\(^{46}\) A limitation in the survival of the AMI is also important to limit its effect on the marketability of the properties. Parties interested in acquiring property may be hesitant to acquire properties subject to an AMI because they will be required to offer interests to the other participants in an area in which they may be actively pursuing properties. The term for the AMI may be longer or shorter than the term of the participation agreement.

The participation agreement should clearly define what will constitute a subsequently acquired interest for purposes of the AMI. Typically a subsequently acquired interest includes any leasehold interest, mineral interest, farmout or royalty interest. In some instances, the parties include the acquisition of an equity interest in another entity that holds interests within the AMI as a subsequently acquired interest. If equity acquisitions are included in the definition of a subsequently acquired interest, the parties must also establish a method for allocating a portion of the purchase price for the corporate acquisition to the interests within the area of mutual interest.

The AMI provision needs to specify the procedure for offering and accepting a subsequently acquired interest. Generally, the acquiring party will provide the non-acquiring parties with information regarding the acquisition, including price, conditions and related terms. The non-acquiring parties are allowed a certain period of time to make their election. The agreement should specify how the election may be made, i.e., written notice and tender of proportionate share of purchase price. Typically, each non-acquiring party must participate in all of the property being acquired and cannot pick and choose as to the portion of the property it will acquire. A party’s failure to timely respond should be addressed; typically a failure to respond is an election not to participate. Area of mutual interest provisions often state that if the proposed acquisition fails to close within a specified period of time, the acquiring party generally has an obligation to offer

\(^{46}\) The Rule Against Perpetuities has been set forth as follows: “no interest [in property] is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.” Melcher v. Camp, 435 P.2d 107, 111 (Okla. 1967)(citing John Chipman Gray, The Rule Against Perpetuities 19 (4th ed. 1906)).
an interest to the non-acquiring parties again if a subsequent acquisition covering the same lands occurs.

The participation agreement should specify how subsequently acquired interests situated partially within and without the area of mutual interest will be handled. The parties may agree that the acquiring participant must offer the other participants their respective shares of the acquired interest, only insofar as the acquired interest relates to the lands within the AMI. As an alternative, the parties may agree that the acquiring participant must offer the other participants their respective shares of the acquired interest, insofar as the acquired interest relates to lands both within and without the AMI, and the participants may acquire their proportionate share of the offered interest, either in its entirety (as it relates to lands within and without the AMI) or only insofar as it relates to lands within the AMI. The third alternative is that the participant being offered its proportionate share of an acquired interest must take its proportionate share insofar as it relates to the entirety of the acquired interest (as it relates to lands within and without the AMI) or not at all.47

The parties may have initially established the boundaries of an area of mutual interest in a participation agreement in an arbitrary manner because they did not know at the time of entering into the agreement which regions would be productive. The parties may, therefore, intend to include lands that are included both within and outside of an AMI as a subsequently acquired interest if the acquisition pertains to the same geological objectives desired by the participation agreement. It is less likely that the parties intended to have acquisitions in which only a small portion of the land acquired is included within the AMI as subsequently acquired interests for purposes of the participation agreement. The participation agreement needs to clearly address this issue.

There are a variety of ways to value the portion being offered pursuant to the AMI. The simplest method for valuation is to take to the actual leasehold costs divided by the net mineral acres included in the transaction, then multiply the result by the area contained within the AMI. If consideration

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47 Lynch, supra note 20, at 17-16.
other than cash is being offered for a subsequently acquired interest, such as
the stock of the acquiring party or overrides, the determination of the value
of the subsequently acquired interest becomes more complicated. In such
cases, the fair market value must be determined, often by a third party such
as an accountant experienced in oil and gas matters.

After the exploration phase, participation agreements typically provide
that the area included within the AMI in the participation agreement not
then subject to jointly held leases is released from the AMI. The AMI is then
limited to only those areas in which the participants own joint interests.

§ 10.06. Assignability of a Participation Agreement.

During the development phase, parties are often hesitant to allow the
other participants to assign their interests to third parties. Assignability
may be an issue because one participant is entering into the participation
agreement based on another participant’s expertise or contacts within the
exploration area. Such a participant would be concerned that an assignee
would not have that same level of expertise or contacts, thus causing the
participant to not receive the benefits from the arrangement that it desires.
Participants may also be concerned that an assignee will not have the
financial wherewithal to satisfy the obligations necessary to complete the
development.

Most participation agreements provide that any assignment requires
the consent of the other participants. Some parties try to negotiate that such
consent may be withheld in their sole discretion; however, generally the
parties agree that consent cannot unreasonably be withheld. Withholding
consent will typically be considered reasonable if the potential assignee has
financial problems.

In some instances the parties place parameters on characteristics of an
assignee that would cause them to be unacceptable as an assignee. Probably
most industry players know other industry players that they would not choose
to deal with, yet no savvy company would ever put together a written list
of prohibited assignees. To give themselves some ability to withhold their
consent and still have a refusal to consent constitute a reasonable refusal,
the parties can list certain characteristics of an assignee that would cause an
assignee to be unacceptable. The following is an example of such a listing of
characteristics: “(i) an assignment would likely have a significant detrimental effect on Promoter or the operations to be conducted hereunder, (ii) the proposed assignee does not have the financial capability to meet prospective obligations arising out of this Agreement, or (iii) such assignment would likely result in Operator suffering a loss of operatorship for any reason, including without limitation, Promoter owning less than fifty percent (50%) of the aggregate working interest in the applicable area the potential assignee owns sufficient interests in the acreage that it could vote for a change of the operator.”

Certain transfers should be excluded from the restrictions on transfers. Mortgages and other financing transactions, transfers to a parent, subsidiary or affiliate, transfer by merger, reorganization, and consolidation or a sale of all of a participants’ oil and gas assets should be excluded from the restrictions on transfers. To avoid a party from avoiding the transfer restrictions by transferring its interests to an affiliate and then having the affiliate sell the interest to a third party, either the affiliate must become bound by the restrictions on transfer or the participation agreement should provide that in the event of any potential transfer by the affiliate, the interest must first be reconveyed to the original participant.

The agreement should require that any transfer of right, interests and obligations that is allowed be made expressly subject to the participation agreement and any JOAs, with the assignee expressly assuming its proportionate share of all post-assignment obligations. An assignor will typically remain liable for post-assignment liabilities of its assignee under the concept of privity of contract.48 If a participant wants to not have any liability for post-assignment obligations, it should expressly reserve the right to do so in the participation agreement.

Parties that enter into joint development projects typically do so not only based on the acreage and funding offered by the other parties, but also because of the management and operation skills of the other parties.

Participation agreements, therefore, may include provisions that give the parties the right to buy the others’ interest in the development area in the event a party has a change of control or gives the other parties the right to sell their interests along with the party undergoing a change of control.49

The parties may want to include a right of first offer provision. A right of first offer provides some advantages because the other participants will probably have the best idea of the value of the interest and a desire to keep third parties from acquiring an interest in the exploration area. Under a right of first offer, a participant that wants to sell all or a portion of its interest in the exploration area must first allow the other participants to make an offer to purchase the interest. If no participant elects to purchase the interest, the participant who wants to sell can then offer the interests to third parties (subject to the other transfer restrictions contained in the agreement). If the interest is not sold within a certain period of time (such as 120 days), the participant desiring to sell its interest must once again offer the interest to the other participants before once again offering it to third parties.

After the termination of a participation agreement, assignability is governed by the applicable JOAs. JOAs do not typically restrict assignment, except to the extent assignment is restricted by compliance with the maintenance of uniform interest provision in the JOA and the preferential right provision, if any, and any tag-along or drag-along provisions that the parties have included in the Other Provisions article of the JOA.

§ 10.07. Miscellaneous Provisions of a Participation Agreement.50


The excuse of force majeure is an accepted defense to enforcement of a contract. Under this defense, a party is relieved of its burden to perform

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49 Article XI of the E&D Form contains examples of provisions addressing assignability, including a tag-along right.
50 For further information on the boilerplate provisions contained in contracts, please see Tina L. Stark, et al., Negotiating and Drafting Contract Boilerplate (2003). The book not only gives detailed information about the history and necessity for boilerplate provisions, but also provides excellent drafting suggestions.
because an event has rendered its performance impossible. When drafting a *force majeure* provision for a participation agreement, the primary question is which events will constitute *force majeure* events? What if performance is possible but only at a tremendous cost? Resolving these issues will depend on the degree of business risk that each participant is willing to bear.

A definition of *force majeure* is typically a list of potential events or acts that will be treated as *force majeure* events. The list includes such events as war, riots, acts of God, terrorist acts, or strike. In addition to the typical events, some participants may assess the likelihood of particular events occurring during the development of the project and request that such events be included in the definition of *force majeure* – thereby shifting the risk to the other participants. Such events may include “unavailability of drilling rigs” or “unavailability of water.”

The occurrence of a *force majeure* event may have various consequences under a participation agreement, the most common being the suspension of the performance obligations of the nonperforming participant during the continuation of the *force majeure* event. Agreements typically expressly provide that the occurrence of a *force majeure* event will not suspend or eliminate a participant’s monetary obligations under the agreement.

Most *force majeure* provisions require the nonperforming participant to notify the other parties of the occurrence of a *force majeure* event. Some *force majeure* provisions also condition the continued suspension on the nonperforming participant complying with certain covenants, such as requiring the participant to (i) mitigate damages to the participants, (ii) exercise due diligence to overcome the *force majeure* event, and (iii) perform to the extent possible. A breach of such covenants provides a cause of action for damages; perhaps more importantly, by breaching a covenant, the nonperforming participant has failed to satisfy a condition to the continued suspension of performance. Therefore, the suspension of performance terminates and the nonperforming participant is in breach of its primary obligations.51

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The participants may want to include a waiver of jury trial in the participation agreement. If one of the participants is a large institutional client, that participant will probably require a jury waiver provision because it anticipates jurors will be biased against it. Conversely, smaller independents or individuals may prefer a jury trial in order to take advantage of the empathy of the jurors. Nearly all jurisdictions permit parties to waive a jury trial by contract.52

Participation agreements often include a forum selection pursuant to which the parties agree on one or more courts to adjudicate a dispute. Several factors are important in evaluating the strengths and weaknesses of potential forums. One factor is the geographic convenience of litigating in the various jurisdictions. Typically parties want to litigate in their home state, or a nearby location. Issues arise, however, when the parties are located in different states. None of the participants wants to allow another participant to have too much of a home court advantage. For example, a California-based participant will typically not agree to a selection of the courts of Odessa, Texas when the other participant is headquartered in Midland, Texas. Also, care should be taken to verify that a court in one jurisdiction can exercise personal jurisdiction over a participant located elsewhere.

A forum selection can be either permissive or exclusive. A permissive forum designation provision preserves the parties’ ability to later select a different forum in the event subsequent developments change the parties’ original preference. For example, a particular jurisdiction may unexpectedly develop favorable (or unfavorable) law on an issue. Exclusive forum selection is typically selected by large corporations that negotiate similar contracts throughout the country.

[3] — **Dispute Resolution.**

Parties to participation agreements often include dispute resolution provisions. In some of the more complex dispute resolution provisions, the parties elect multiple levels of resolution. For example, in a three-level dispute resolution provision, the senior management of the participants first meet to attempt to resolve the dispute. If management is unable to reach an agreement, in the second level of the resolution process, the parties submit the dispute to mediation. In the event that mediation does not finally resolve the dispute, the third level of the dispute resolution is a submission of the dispute to arbitration. To ensure a prompt resolution of a dispute, the participants should set some limits for each stage of the dispute resolution process. For example, upon a participant notifying the other participants of a dispute, the participants must arrange for their respective members of senior management to meet within five days and that if they cannot resolve the dispute within ten days, either party can elect to mediate the dispute. Once again, the time period to commence and conclude mediation should be expressly stated in the participation agreement.

In determining whether to agree to arbitration, the participants should consider whether the potential dispute is appropriate for arbitration as well as the pros and cons of the arbitration process. For instance, arbitration is more private than a public courtroom, and it may provide a faster and less expensive method of dispute resolution than litigation, but there is no guarantee that this will be true. Unlike decisions in the court system, the decisions of arbitrators are generally final and nonreviewable.

If the participants decide to arbitrate, they should address a variety of matters, including the scope of issues subject to arbitration, the selection of arbitrators, the procedures to be followed, and the applicable body of law. The Federal Arbitration Act (the FAA) requires that federal courts

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53 Section 13.17 of the E&D Form contains an example of a multi-tier dispute resolution provision.
interpret agreements to arbitrate in accordance with their terms. As with the rest of contract law, it is the intent of the parties at the time of the agreement that controls.56 State courts also consider the parties’ intent in interpreting an agreement to arbitrate.

The participants should decide whether to have the arbitration administered by an organization, such as the American Arbitration Association, or to administer it themselves. If administered by an organization, the parties adopt an existing body of rules and procedures to govern the arbitration, but can alter these rules with their own requirements such as limiting the scope of discovery. In the absence of an express statement that arbitration will be administered by an organization, the arbitration will be self-administered.

In a self-administered arbitration, the participants should identify the rules and procedures that will govern the arbitration. The participants can do this by specifying the rules in the agreement, leaving it up to the arbitrator to determine, or incorporating the rules of an arbitration organization, such as the rules of the American Arbitration Association, without submitting the dispute to the organization.

The parties may specify the number of arbitrators to be appointed and the procedures for selecting the arbitrators, including any specific qualifications for the arbitrators. If the parties prefer a panel of three arbitrators, a common approach is for each party to appoint an arbitrator and then for the two party-appointed arbitrators to select a neutral arbitrator. The provision may also state that if the two party-appointed arbitrators cannot agree on the selection of a neutral arbitrator, then an outside authority, such as a judge, a law professor or an arbitration organization, will appoint the third arbitrator. The parties should state whether punitive damages may be awarded in an arbitration.

56 See 1 Wilner, Domke on Commercial Arbitration § 5.02 at 59 (2002 Supp.) (“[T]he parties should state the number of arbitrators, the method of their appointment, the place of the arbitration and preferably the law to be applied, and the rules they wish to have adopted by the arbitrators.”).
The parties should also limit the time within which arbitration may be commenced, the period of time for each party to present its case to the arbitrator, and the time period in which the arbitrator must render his decision. Unfortunately, in parties’ desire to quickly resolve issues, they sometimes contract for time periods that are unrealistic. Discrete issues may be able to be resolved in relatively short time frames, but for more complex matters that involve significant involvement of third party consultants, such as environmental matters, longer periods of time for dispute resolution may be necessary.


As a result of the exploration and development being conducted by the participants, the parties to a participation agreement will be privy to confidential information regarding the properties covered by the exploration area. To protect this information, participation agreements typically include a confidentiality provision designed to prevent the unauthorized use or disclosure of the information. The following discussion highlights some of the issues to be considered when drafting a confidentiality provision but is not an exhaustive list of all the potential issues.

A typical confidentiality provision defines the type of information deemed “confidential” and sets forth exclusions from the definition. It also sets forth the permitted use and disclosure of confidential information, and sometimes sets a standard of care to be used by the recipient of the confidential information. A typical confidentiality provision designates who will be permitted access to confidential information and specifies (i) how long the information is to remain confidential, (ii) procedures to be followed if disclosure is required by law or legal process, and (iii) remedies for breach.

Parties to participation agreements generally provide that a recipient of confidential information may disclose the information to third party lenders or potential investors. Sometimes confidentiality provisions require a party receiving confidential information to agree in writing to be bound to the confidentiality provision; however, this requirement can be quite burdensome — imagine each individual lawyer, accountant and lender in a transaction signing an agreement to be bound. To avoid such a burden, confidentiality
agreements often provide that any third party recipient of confidential information will be notified of the confidentiality provisions and will be deemed bound by them.

Rather than potentially breaching a contract to comply with a competing legal obligation, prudent participants will insist on the right to disclose confidential information under certain circumstances. Such circumstances include a disclosure required by a court or governmental body. The confidentiality provision may require the disclosing participant to give advance notice to the other participants so that the other participants will have time to object to the disclosure by seeking appropriate relief.

Injunctive relief is likely to be the most desirable remedy for a breach of a confidentiality provision. Courts usually require a party to show that its interests would be irreparably harmed if the confidential information were disclosed or improperly used.\(^57\) Monetary relief may also be appropriate even if injunctive relief is available. Participants may request an indemnity for any breach or threatened breach of the confidentiality provision. If the indemnity applies to a threatened breach, the non-disclosing participant can recover its costs of enforcing the agreement prior to the confidential information being disclosed. If not, the primary benefit of an indemnity over a breach of contract action is the scope of items to be considered in calculating damages is increased, for example, an indemnification for attorneys’ fees.

Announcement or publicity provisions are typically found in participation agreements because the participants want to protect their business interests by controlling the disclosure of information. The provisions typically limit the content and timing of the disclosure of both the existence and the terms of the transaction. Announcement provisions often supplement confidentiality provisions.

\(^{57}\) Cont’l Group, Inc. v. Amoco Chem. Corp., 614 F.2d 351, 359 (3d Cir. 1980)(“The requisite for injunctive relief has been characterized as a ‘clear showing of immediate irreparable injury’” (quoting Ammand v. McGahn, 532 F.2d 325, 329 (3d Cir. 1976)); City of San Antonio v. Rankin, 905 S.W.2d 427, 430 (Tex. App. – San Antonio 1995)(“[t]o qualify for temporary injunctive relief, a movant must show . . . imminent, irreparable harm . . .”).
In many participation agreements, the announcing party is required to obtain the consent of the other participants before making the announcement. This veto power forces agreement over the content and timing of the information given to the public. Control over the content of public disclosures is usually the most significant reason to include an announcement provision. Control can be required for a number of reasons, including to avoid disclosing the terms of a transaction where the disclosure could have a harmful competitive effect or to avoid disclosure where the disclosure could complicate future negotiations of similar transactions.

Timing of an announcement regarding the transaction can be important because the parties do not want to disclose the transaction until it has been consummated. Public companies have additional worries concerning the timing of disclosures. Until material information regarding the company is given to the public, persons having access to the information are prohibited from trading in the company’s stock. These restrictions create pressure on public companies to announce a deal sooner rather than later to terminate the trading restrictions. Public companies also worry about the timing of announcements because of the potential impact that the announcements might have on stock trading prices.

All announcement provisions that include a veto right should contain an exception permitting disclosures to be made to the extent disclosure is required by law or legal process. A participant should not be in breach of its obligations under the participation agreement if a law, regulation or court order requires disclosure.


[a] — Audit Rights.

Participants should have the right to audit the operator’s records regarding the financial aspects of the project. The audit right provision should restrict a participant’s right to audit to the normal business hours of

58 Trading on the basis of non-public information may give rise to both civil and criminal liability. See United States v. O’Hagan, 521 U.S. 642, 117 S. Ct. 2199 (1997)(the misappropriation of non-public information subjects the trader to criminal and civil liability under the anti-fraud provisions in Section 10(b) of the Securities Exchange Act of 1934).
the operator after reasonable advance notice. The right to audit should be limited to a certain look back period, say the records for the immediately preceding two years.

If a participant’s working interest is being carried by another participant, the holder of the carried interest also typically has the right to audit the other participant’s records regarding the carry, particularly with respect to the calculation of payout. Once again, the audit rights need to have some limitations so that the audit is not unreasonably burdensome to the participant being audited.

[b] — Limitation on Special and Consequential Damages.

Consequential damages take into account all the ripple effects from a breach of contract, including lost profits, lost opportunities, legal fees and other out-of-pocket expenses not otherwise directly related to the breach. Every agreement holds the possibility of consequential damage recovery unless the agreement expressly excludes or limits these types of damages. Participation agreements typically disclaim special and consequential damages as between the participants.

c] — No Third Party Beneficiaries.

Participation agreements generally provide that no third party has enforceable rights and remedies under the agreement. It is advisable to have this provision because a court may rule that a beneficiary exists even when the parties did not intend one. A third party beneficiary provision should always be paired with a merger provision that states the writing constitutes the entire agreement between the parties and that all prior negotiations are merged into the written contract. The inclusion of a merger provision is important if there are related agreements because of the possibility that the parties to the ancillary agreements could be deemed third party beneficiaries of the participation agreement.59

59 See Bush v. Brunswick Corp., 783 S.W.2d 724 (Tex. App. – Fort Worth 1989). The merger agreement provided that it did not confer “upon any other person any rights or remedies hereunder.” The agreement did not, however, provide that it was the entire
[d] — Amendments and Waivers.

Agreements typically provide that the contract can be amended only by written agreement of the parties. Participation agreements also typically state that no provision of the agreement may be waived, except pursuant to a writing executed by the party against whom the waiver is sought to be enforced.

[e] — Governing Law.

A governing law provision ensures that the law of a designated jurisdiction will govern the dispute, regardless of where the dispute is adjudicated. For example, if a participation agreement provides that Texas law will govern the agreement and a dispute is brought in an Oklahoma court, the Oklahoma court will apply Texas law in resolving the dispute. The participants may choose the same jurisdiction for both governing law and forum selection purposes, or they may elect to have the law of one state govern the agreement and a different state for adjudication. In determining the governing law for a participation agreement, the participants should look at the proposed state, often the state in which the exploration area is located, and evaluate whether or not such state has a well-developed body of oil and gas law. If not, another state which has a more developed body of oil and gas law, such as Texas, may be a better choice for the governing law.

[f] — Covenants Running with the Land.

Covenants running with the land are promises that touch and concern the land and are enforceable against subsequent grantees of the land if certain requirements are met. Because a lease is an interest in land, and the parties to a participation agreement typically make an exchange of leases or interests in leases, an agreement that the terms of the development will run with the leasehold interests provides additional security that the obligations imposed agreement between the parties. The appellate court, therefore, read the merger agreement together with a related lockup agreement and held that the shareholders who were parties to the lockup agreement were beneficiaries of the merger agreement. The shareholders were then allowed to sue for breach of the merger agreement.
by the participation agreement will attach to the third party receiving an interest in the leases. A covenants running with the land provision should probably be coupled with a provision to the effect that any assignment of an interest subject to the agreement will be made subject to, and the assignee will assume the terms and conditions of the participation agreement.

[g] — Multiple Counterparts.

Counterpart provisions are generally enforceable. A counterpart provision restates the common law rule that parties to a contract may create more than one original of a written agreement. Counterpart provisions often now permit delivery of executed counterparts by facsimile. Some jurisdictions have sanctioned delivery by facsimile, while others have not.

[h] — Further Assurances.

A further assurances provision is a general provision designed to require the parties to exercise a certain degree of effort to achieve the agreement’s objectives. It recognizes that the parties cannot draft for every contingency. A key issue is the standard of effort required by the parties in effecting the purposes of the agreement. Case law suggests that a “best efforts” standard is more rigorous than a standard of “reasonable efforts.” Accordingly, most agreements provide that the parties will use reasonable efforts.

§ 10.08. Conclusion.

The participation agreement has become the dominant form of cooperative form that industry players use to pursue new, unconventional

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opportunities. Such relationships allow companies to bring together their respective lands, leases, funds and expertise to achieve more in concert than either, acting alone, ever could. This is particularly important given the state of the credit markets that — while improving — have not yet fully recovered. However, as discussed such arrangements are not without potential pitfalls that drafters of participation agreements must take into consideration. What is, on the surface, a straightforward agreement between two parties to cooperate, involves many moving parts.

Despite this, most of these hazards can be avoided or minimized by careful drafting, consideration of potential courses of events, and communication with the dealmakers regarding the relationship they desire to see between their companies, and the relationship actually spelled out in their agreement.
Appendix I

Please note that this form is being provided simply as a framework for an exploration and development agreement. By their nature, exploration and development agreements are very deal-specific. The authors have not attempted to provide alternatives for all of the potential terms that participants may want incorporated in an agreement.

This form assumes that Eureka Oil Company developed the original geologic idea and has assembled an acreage position. New Money Oil Corporation is a company that is experienced in the oil and gas business but has not previously developed acreage in the area covered by the AMI. Most importantly, New Money Oil Corporation has funds available to help with the development of the acreage.

SAMPLE FORM

EXPLORATION AND DEVELOPMENT AGREEMENT

EUREKA OIL COMPANY

and

NEW MONEY OIL CORPORATION

Dated May 15, 2010
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EXPLORATION AND DEVELOPMENT AGREEMENT

This Exploration and Development Agreement is entered into as of May 15, 2010 (this “Agreement”), by and among Eureka Oil Company, a Delaware corporation (“Eureka”) and New Money Oil Corporation, a New Mexico corporation (“Participant”). Eureka and Participant and their successors and assigns are sometimes collectively referred to herein as “Parties” and each individually as a “Party.”

WITNESSETH:

WHEREAS, Eureka has acquired an interest in certain oil, gas and leaseholds within the AMI (as defined below);

WHEREAS, Participant seeks to earn an undivided forty percent (40%) interest in, among other things, certain oil, gas and leaseholds within the AMI by fulfilling its obligations under this Agreement;

WHEREAS, the Parties intend that all of their interests in such leaseholds shall be subject to a tax partnership for U.S. federal income tax purposes, as described herein;

WHEREAS, the Parties desire to establish an AMI to address the participation of Participant and Eureka in the acquisition of AMI Interests (as defined below); and

WHEREAS, the Parties desire to enter into this Agreement to govern certain of their rights and responsibilities with respect to the exploration and joint development of the lands within the AMI.

NOW, THEREFORE, in consideration of the premises, the mutual covenants, agreements and obligations set forth herein, and the mutual benefits to be received hereunder, the Parties hereto agree as follows:

ARTICLE I
DEFINITIONS

1.1 Definitions. For the purposes of this Agreement, the following terms shall have the meanings designated below:

(a) “Acquiring Party” has the meaning given it in Section 6.2(a).
(b) “AFE” means an authority for expenditure issued pursuant to the terms of this Agreement and the applicable Operating Agreement or Third Party JOA.

(c) “Affiliate” means (a) any Person directly or indirectly owning, controlling or holding with power to vote 50% or more of the outstanding voting securities of any other Person, (b) any Person 50% or more of whose outstanding voting securities are directly or indirectly owned, controlled or held with power to vote by any other Person, (c) any Person directly or indirectly Controlling, Controlled by or under common Control with any other Person, and (d) any officer, director, partner or sanguinal or affinal kin of any other Person or any Person described in subsection (c) of this paragraph.

(d) “Agreement” has the meaning given it in the preamble.

(e) “AMI” means collectively, the Primary Acreage AMI and the Secondary Acreage AMI.

(f) “AMI Interest” means any Lease, mineral servitude, license, or concession (or a contractual right to acquire any Lease, mineral servitude, license or concession) or an undivided interest therein or portion thereof, together with all appurtenances, easements, permits, licenses, servitudes and rights-of-way situated upon or used or held for future use in connection with such an interest or the exploration, development or operation thereof. “AMI Interest” shall also mean and include all rights and interests in all lands and interests unitized or pooled therewith pursuant to any law, rule, regulation or agreement.

(g) “AMI Notice” has the meaning given it in Section 6.3(d).

(h) “AMI Share” means:
(i) with respect to the Primary Acreage AMI, the rights of the Parties to participate in the following percentages:

(A) with respect to Eureka, an undivided sixty percent (60%) undivided interest; and

(B) with respect to Participant, an undivided forty percent (40%) undivided interest.

(ii) with respect to the Secondary Acreage AMI, the rights of the Parties to participate in the following percentages:

(A) in the event Eureka is the Acquiring Party,

(1) with respect to Eureka, an undivided sixty percent (60%) interest;

(2) with respect to Participant, an undivided forty percent (40%) interest; and

(B) in the event Participant is the Acquiring Party,

(1) with respect to Eureka, an undivided forty percent (40%) interest;

(2) with respect to Participant, an undivided sixty percent (60%) interest;

provided, however, if less than all of the Non-Acquiring Parties validly elect to acquire any AMI Interest pursuant
to Article VI, then the AMI Share of each Non-Acquiring Party that fails to validly elect to acquire such AMI Interest shall be proportionately allocated to the Acquiring Party and each Non-Acquiring Party that validly elect to acquire such AMI Interests pro rata in proportion to the respective AMI Shares.

(i) “AMI Term” has the meaning given it in Section 6.9.

(j) “Annual Budget” has the meaning given it in Section 5.4.

(k) “Applicable Laws” means all federal, state or local laws, rules, orders or regulations in effect on the date of this Agreement and applicable to Eureka, the Properties or this Agreement and the transactions contemplated hereby.

(l) “Assignment” has the meaning given it in Section 6.6.

(m) “Business Days” means a day on which banks are generally open for business in Dallas, Texas other than a Saturday, Sunday or statutory holiday in Dallas, Texas.

(n) “Carry Amount” means the amount of $30,000,000.00.

(o) “Change of Control” means, with respect to each Party, the failure of the Existing Control Group of such Party to have Control.

(p) “Contract Area” means an area of land to be designated as the “contract area” in, as applicable,

(i) an Operating Agreement, provided that, each such designated area of land shall not exceed (A) until such time as Participant has expended the entire Carry Amount, 1,000 acres, and (B) at all times
thereafter, 640 acres plus or minus ten percent (10%), or

(ii) a Third Party JOA.

(q) “Control” means the possession, directly or indirectly, of the following
(i) in the case of a corporation, more than 50% of the voting power of the outstanding securities thereof;
(ii) in the case of a limited liability company, partnership, limited partnership or venture, more than 50% of the voting power of the interests thereof; or
(iii) in the case of any other Person, the power to direct or cause the direction of the management and policies of a Person, whether through the ability to exercise voting power, by contract or otherwise, and “Controlled” and “Controlling” have the meanings correlative thereto.

(r) “Conveyance” has the meaning given it in Section 2.1.

(s) “Corporate Acquisition” means the acquisition by any Party of the Control of any Third Party which owns any interests located within the AMI.

(t) “Default” has the meaning given it in Section 4.3.

(u) “Development Plan” means the development plan attached hereto as Exhibit “G”.

(v) “Disputes” has the meaning given it in Section 13.17.

(w) “Effective Date” means April 1, 2010.

(x) “Eureka’s Express Warranties” has the meaning given it in Section 10.1.
“Eureka’s Indemnified Claim” have the meanings given it in Section 8.1

“Existing Control Group” means with respect to each Party, the Persons who have Control of such Party as of the date of this Agreement.

“Fair Market Value” means:

(i) with respect to any AMI Interest that comprises a Subsequently-Acquired Interest covering lands that are completely within the AMI, the total cost expended for such AMI Interest, which cost shall include all Lease Acquisition Costs associated therewith;

(ii) with respect to any AMI Interest that comprises a Subsequently-Acquired Interest covering lands that are both within and outside of the AMI, an amount equal to the fair market value of such AMI Interest as a cash price at which the AMI Interest or non-cash consideration, as applicable, would change hands between a bona fide willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of the relevant facts. “Fair Market Value” for any AMI Interest that comprises a Subsequently-Acquired Interest covering lands that are both within and outside of the AMI, shall be determined (a) by agreement of the Non-Acquiring Parties and the Acquiring Party, or (b) if the Non-Acquiring Parties and the Acquiring Party have not agreed upon a Fair Market Value within ten (10) Business Days after receipt of the
applicable notice required under Article VI, then an independent Third Party shall determine Fair Market Value within twenty (20) days after receipt of the applicable notice required under Article VI. If Fair Market Value is determined by an independent Third Party, (1) such independent Third Party shall be an investment bank or financial institution of recognized national standing in the oil and gas industry with respect to valuing AMI Interests, (2) the Acquiring Party will provide such information regarding such AMI Interest as such independent Third Party may reasonably request, (3) the costs of such independent Third Party shall be shared equally by the Non-Acquiring Parties and the Acquiring Party, and (4) the determination of Fair Market Value by the independent Third Party shall be conclusive, final and binding on all applicable Parties and may be entered and enforced in any court having jurisdiction thereof in accordance with Applicable Laws. On or before January 1 of each year, the Parties shall designate an independent Third Party for the twelve consecutive month period commencing on such date; and

(iii) with respect to any AMI Interest that comprises a Subsequently-Acquired Interest acquired in a Corporate Acquisition, the fair market value of such AMI Interest shall be determined in accordance with either the preceding clause (i) or (ii) of this definition, as applicable, as adjusted for corporate liabilities assumed by the Acquiring Party that are reasonably allocated to such Subsequently-Acquired Interest, any such allocation shall be determined (a) by agreement of the Non-Acquiring
Parties and the Acquiring Party, or (b) if the Non-Acquiring Parties and the Acquiring Party have not agreed upon such allocation within ten (10) Business Days after receipt of the applicable notice required under Article VI, by a Third Party within twenty (20) days after receipt of the applicable notice required under Article VI; provided that any determination by a Third Party shall be made in accordance with the provisions of the immediately preceding clause (ii) that govern the selection of the independent Third Party, the information to be provided to such Third Party, the Parties’ sharing of costs of such Third Party, and the conclusive nature of determinations by such independent Third Party.

(bb) “Farmout” means any contract right whereby one or more Leases, or an interest therein, may be earned by the drilling of one or more wells.

(cc) “Force Majeure” has the meaning given it in Section 13.16.

(dd) “Geoscientific Data” means all geological and/or geophysical maps, surveys, field tapes, data, processings, interpretations, prospects, and other related information now owned or hereafter acquired by Operator with respect to the AMI.

(ee) “Indemnified Person” has the meaning given it in Section 13.8.

(ff) “Indemnitee” has the meaning given it in Section 8.4.
(gg) “Initial Settlement Statement” has the meaning given it Section 7.2

(hh) “Internal Revenue Code” means the Internal Revenue Code of 1986 and any successor statute, as amended from time to time.

(ii) “Jointly-Owned Lease” means a Lease, insofar as it covers lands lying within the AMI, in which each of the Parties owns or acquires a Working Interest pursuant to the terms of this Agreement.

(jj) “Lease” means any oil and gas lease, oil, gas and mineral lease, operating rights or other rights or agreement, or a partial interest therein, insofar as such Lease covers some portion of the AMI, which authorizes the lessee thereunder to explore for and/or produce oil and/or gas, and/or the right to acquire any of the foregoing. The term also includes top leases, Farmouts, or any other type of agreement (including any Option, hereinafter defined) under which a Party can earn the right to explore and/or develop a portion of the AMI and hydrocarbon producing wells located on any Lease.

(kk) “Lease Acquisition Costs” means, with respect to any Lease, the sum of (i) all direct out of pocket consideration paid to lease brokers, landmen, geologists and engineers in connection with the acquisition of such Lease, including without limitation, any incentive overriding royalty interests or participations assigned to lease brokers, landmen, geologists and engineers, and (ii) all direct out of pocket costs incurred in the acquisition of such Lease, including purchase prices, bonuses, delay rentals (if such Lease is not a paid up Lease), filing fees, and title curative costs; provided, however, “Lease Acquisition Costs” shall in no
event include any amounts owed or paid to any Party hereto or any Affiliate of any Party hereto.

(ll) “Lease Burden” means any royalty, overriding royalty interest, net profits interest, production payment, carried interest, reversionary working interest, right to participate or other charge upon a leasehold interest or the production therefrom, but only to the extent, in each case, any of the forgoing is (a) granted or imposed by a Third Party to another Third Party or (b) granted or imposed by a Party to any Third Party as required to make such grant pursuant to the terms of the existing agreements and contracts described on Exhibit “H” attached hereto.

(mm) “Net Revenue Interest” means the decimal interest in and to all production of the Hydrocarbons produced and saved or sold from a Property after giving effect to all valid lessors’ royalties, overriding royalties, production payments and other non-expense bearing burdens against production.

(nn) “Non-Acquiring Party” has the meaning given it in Section 7.2(a).

(oo) “Nonpayment Event” has the meaning given it in Section 4.3.

(pp) “Operating Agreement” means a joint operating agreement, in substantially the form attached hereto as Exhibit “B”, entered into between the Parties in accordance with Section 5.2.

(qq) “Operating Committee” has the meaning given it in Section 5.3.
(rr) “Operator” means, for (i) lands within the Primary Acreage AMI, except as provided in Sections 4.2 and 4.5, Eureka, and (ii) with respect to any particular lands within the Secondary Acreage AMI, (1) if Eureka is the Acquiring Party of such lands, Eureka, or (2) if Participant is the Acquiring Party of such lands, Participant.

(ss) “Operator Obligations” has the meaning given it in Section 12.5.

(tt) “Option” means an agreement that entitles a Party to an option to acquire a Lease covering lands within the AMI.

(uu) “Participant Operated Wells” has the meaning given it in Section 4.2.

(vv) “Participant’s Indemnified Claim” and “Participant’s Indemnified Claims” have the meanings given them in Section 8.2.

(ww) “Participant’s Share” means an undivided forty percent (40%) non-operating interest.

(xx) “Partitioned Interest” has the meaning given it in Section 6.2(b).

(yy) “Party” and “Parties” have the meanings given them in the preamble.

(zz) “Payment Date” has the meaning given it in Section 4.3.

(aaa) “Permitted Liens” shall mean (A) liens for taxes which are not yet delinquent or which are being contested in good faith and for which adequate reserves have been established; (B) normal and customary liens of operators and co-owners arising under operating agreements, unitization agreements,
and pooling orders relating to the Properties, which, in each case, arise in the ordinary course and obligations are not yet due and pursuant to which Eureka is not in default; (C) mechanic’s and materialmen’s liens relating to the Properties arising by operation of Applicable Laws, which, in each instance, arise in the ordinary course and obligations are not yet due and pursuant to which Eureka is not in default; (D) liens in the ordinary course of business consisting of minor defects and irregularities in title or other restrictions (whether created by or arising out of joint operating agreements, farm-out agreements, leases and assignments, contracts for purchases of Hydrocarbons or similar agreements, or otherwise in the ordinary course of business) which would be accepted by a reasonably prudent and sophisticated buyer engaged in the business of owning or operating oil and gas properties; (E) easements, rights-of-way, servitudes, permits, surface leases and other rights in respect of surface operations, pipelines, grazing, logging, canals, ditches, reservoirs or the like, and easements for streets, alleys, highways, pipelines, telephone lines, power lines, railways and other easements and rights-of-way, on, over or in respect of any of the Property to the extent such matters would be accepted by a reasonably prudent and sophisticated buyer engaged in the business of owning or operating oil and gas properties; and (F) any deed of trust, mortgage or other lien created by a lessor (other than Eureka or any of its Affiliates to the extent Eureka or Affiliates holds title to minerals burdened by such Lease as of the date hereof) prior to the execution of the Lease burdened by any such lien.

(bbb) “Person” means an individual, corporation, partnership, limited liability company, association, joint stock company, trust or trustee thereof, estate or executor thereof,
unincorporated organization or joint venture, or any other legally recognizable entity.

(ccc) “Primary Acreage AMI” means the lands (including all depths) depicted on the map attached hereto as Exhibit “A-1” and as further described in the narrative on Exhibit “A-1”.

(ddd) “Proceedings” means all proceedings, actions, claims, suits, hearings, investigations and inquiries before any arbitration or Governmental Entity.

(eee) “Promoted Wells” has the meaning given it in Section 4.3.

fff) “Promoted Well Costs” has the meaning given it in Section 4.3.

(ggg) “Properties” means the following described properties, rights and interests:

(a) all of Eureka’s rights, titles, interests and obligations in and to the oil, gas or mineral leases described on Exhibit A-3;

(b) all rights, titles, interests and obligations of Eureka in and to all operating agreements and other agreements, contracts, licenses, permits, authorizations, surface use agreements, easements, rights-of-way and surface rights, production sales contracts, operating agreements, and other agreements and contracts related to or necessary for the ownership or operation of any of the properties described in subsection (a) above, including those described on Exhibit A-4;
(c) all rights, titles, interests and obligations of Eureka in and to all operating agreements and other agreements, contracts, licenses, permits, authorizations, surface use agreements, easements, rights-of-way and surface rights, production sales contracts, operating agreements, and other agreements and contracts related to or necessary for the ownership or operations of any of the properties described in subsection (a) above;

(d) all rights, titles, interests and obligations of Eureka in and to all materials, supplies, machinery, equipment, improvements and other personal property and fixtures (including, but not by way of limitation, all wellhead equipment, pumping units, oil, gas water, wellsite flowlines, tanks, buildings, injection facilities, saltwater disposal facilities, compression facilities, and other equipment) and are used in connection with the exploration, development, operation or maintenance thereof;

(e) any seismic data, geological or geophysical data, or other similar data relating to the foregoing described property or any interpretations thereof or other data or records related thereto but only to the extent that Eureka may assign or transfer such data under its existing agreements and licenses without making any additional payments or incurring any liability or obligation; and

(f) subject to any third party rights, all of Eureka’s lease files, title opinions, production records, well files, accounting records (but not including general financial and accounting records attributable to
Eureka’s business), gravity maps, electric logs, and other files, documents and records of every kind and description which relate to the properties described above (the “Records”); provided, however that Eureka may retain the originals of any or all the Records.

(hhh) “Proportionate Share” except as otherwise provided for herein, shall be calculated by dividing a Party’s Working Interest, by the aggregate of the Working Interests of all Parties who are to share an obligation or pay an amount pursuant to the terms hereof.

(iii) “Reassignment” has the meaning given it in Section 4.3.

(jjj) “Renewal or Extension Lease” has the meaning given it in Section 6.5.

(kkk) “Secondary Acreage AMI” means lands (including all depths) depicted on the map attached hereto as Exhibit “A-2” and as further described in the narrative on Exhibit “A-2”.

(lll) “Selling Party” has the meaning given it in Section 11.2.

(mmm) “Subsequently-Acquired Interest” means, as of the Effective Date (a) the direct or indirect option, right or opportunity by any Party or its Affiliate to acquire, directly or indirectly, any AMI Interest in the AMI, whether such option, right or opportunity is through a purchase, exchange, partnership, joint venture, AMI Interest, participation agreement, Farmout, operating agreement or any similar arrangement, or the direct or indirect acquisition of voting control of an entity which owns or holds a Subsequently-Acquired Interest, including a Corporate Acquisition. Subsequently-
Acquired Interest shall not include any acquisition by any Party or its Affiliate of an interest in any Party hereto or from any other Party or any issuance of additional interests by the Non-Acquiring Parties. Any option, right or opportunity to acquire any additional interest in, or any depths above or below those specified in any AMI Interest(s) owned or held by a Party shall constitute a Subsequently-Acquired Interest.

(nnn) “Subsequently-Created Burden” means a Lease Burden that a Party imposes on its interest subsequent to its acquisition of that interest.

(ooo) “Survival Period” has the meaning given it in Section 8.3.

(ppp) “Tag-Along Notice,” “Tag-Along Party,” and “Tag-Along Sale Date” have the meanings given them in Section 11.2.

(qqq) “Term” has the meaning given it in Section 13.1.

(rrr) “Third Party” means any Person other than a Party or an Affiliate of a Party.

(sss) “Third Party JOA” means a joint operating agreement between the Parties and a Person other than a Party or an Affiliate of a Party in circumstances where it is not possible to use an Operating Agreement.

(ttt) “Third Party Transfer” has the meaning given it in Section 11.2.

(uuu) “Through the Tanks” shall mean all operations necessary to drill and complete a well and install related equipment reasonably necessary for the well to be capable of producing
oil or gas to tanks or pipelines, as applicable, including all production, processing, and flowline facilities necessary to connect into and deliver oil or gas to a transportation pipeline in accordance with transportation pipeline specifications set forth in the Gas Gathering Agreement attached hereto as Exhibit “D”.

(vvv) “Title Defect” has the meaning given it in Section 3.4(a).

(www) “Underlying Agreements” means any contracts, instruments, agreements or other documents pursuant to which a Party or its Affiliate has rights to acquire or participate in the acquisition and/or development of any AMI Interest within the AMI.

(xxx) “Well” means any well that is drilled on a Jointly-Owned Lease.

(yyy) “Well Costs” means as to any Well, all costs incurred prior to the removal of the flowback equipment from the Well site (but in no event later than ninety (90) days after the date of first sale of production from such Well) for the drilling, equipping, evaluating and completing Through the Tanks (or plugging and abandoning, if not completed) of such Well, the original estimated amounts of which have been set forth in an AFE. For purposes of this Agreement, “Well Costs” shall include all costs incurred in the drilling, equipping, evaluation and completion Through the Tanks (or plugging and abandoning) of a Well including, without limitation, the following costs: costs of acquiring, by purchase, lease or otherwise, of surface sites for drilling and completion, constructing and upgrading access roads, obtaining and preparing the location, obtaining permits and additional title opinions, obtaining drilling contractor
services and consultants, obtaining mud chemicals, wellhead equipment, tubing, pipe and supplies, separators, flowlines, water disposal, water acquisition, all other costs and expenses associated with or incurred in moving in, rigging up, drilling, logging and testing so that a decision can be made to either attempt to set pipe and complete such Well Through the Tanks or to plug and abandon such Well as a dry hole, and costs of fracture stimulation and the drilling out of frac plugs.

(zzz) “Working Interest” means the percentage interest in the leasehold estate in any property and all rights and obligations of every kind and character pertinent thereto or arising therefrom, without regard to any valid lessor royalties, overriding royalties and other burdens against production insofar as said interest in such leasehold is burdened with the obligation to bear and pay the cost of exploration, development and operation.

ARTICLE II
PROPERTIES

2.1 Property. Concurrently herewith, Eureka shall execute, acknowledge and deliver to Participant a conveyance of Participant’s Share of the Properties (the “Conveyance”) in the form attached hereto as Exhibit “C”, effective as of the Effective Date.

2.2 Gas Gathering Agreement. On the Closing Date, Eureka and Participant shall enter into a gas gathering agreement in the form attached hereto as Exhibit “D”.

ARTICLE III
ACQUISITION OF PARTICIPANT’S PROPORTIONATE SHARE

3.1 Acquisition of Participant’s Proportionate Share. Participant agrees to acquire, and Eureka agrees to sell, Participants’ Share of the Properties on the terms and conditions set forth in this Agreement. The consideration therefor shall be (i) $15,000,000 payable by Participant by wire transfer to
Eureka concurrently herewith (the “Cash Payment”), and (ii) the payment of the Carry Amount pursuant to the terms of this Agreement.

3.2 Access to Records. Following the execution of this Agreement, Eureka will continue to make available for Participant’s examination, during normal business hours, access to the Records (and Participant shall have the right to copy such information at its expense).

3.3 Good and Marketable Title. As used herein, the term “Good and Marketable Title” shall mean that title of Eureka in and to the Leases, which:

(a) Entitles Eureka to all of the oil and gas leasehold and operating rights in the net oil and gas mineral acres set forth in Exhibit A-3.

(b) Obligates Eureka to bear not more than that share of costs and expenses relating to the maintenance and development of and operations on the land covered by each Lease equal to Eureka’s net mineral acres covered by such Lease divided by the gross mineral acres in the land covered by such Lease.

(c) Entitles Eureka to receive not less than that share of oil, gas and other minerals produced from the land covered by each Lease equal to (i) Eureka’s net mineral acres covered by each Lease divided by the gross mineral acres in the land covered by the Lease, multiplied by (ii) 100% less the landowner’s royalty and existing overriding royalties set forth in Exhibit A-3.

(d) Except for the Permitted Liens, is free and clear of all mortgages, liens, charges, claims, burdens, encumbrances and defects in title.

(e) Except for Permitted Liens, is deducible of public record and is free from reasonable doubt to the end that a prudent person engaged in the business of ownership, exploration, development and operation of oil and gas Leases with knowledge of all the facts and their legal bearing would be willing to accept the same.
3.4 Title Defects and Adjustments of Purchase Price.

(a) If the Records or any other information or data reflect the existence of any encumbrance, encroachment, defect or objection with respect to title, which renders the title not Good and Marketable Title and which Participant desires to have cured (“Title Defect”), Participant shall notify Eureka and Eureka shall have the right but not the obligation to cure any such Title Defect. In connection with this examination of title data, Participant shall notify Eureka in writing of any Title Defect no later than 30 days after the date of this Agreement. Any Title Defect of which Participant does not deliver notice to Eureka by such deadline shall be deemed waived.

(b) If a Title Defect is not cured or removed to the reasonable satisfaction of Participant not later than 30 days after the date of this Agreement and Participant does not waive the Title Defect, Carry Amount shall be reduced by an amount equal to $1,000 per net mineral acre affected by each such uncured and unwaived Title Defect.

ARTICLE IV
WELLS

4.1 Well Proposals. Until such time as Participant has expended the entire Carry Amount pursuant to Section 4.3, except as provided in Sections 4.2 and 4.5, Eureka shall have the sole right to propose wells within the Primary Acreage AMI. After Participant’s expenditure of the entire Carry Amount, any Party may propose wells, in accordance with the terms of the applicable Operating Agreement, Third Party JOA, or Section 12.3.

Each well proposal shall include (i) an AFE for the proposed well and (ii) a proposed Contract Area, if the proposed well will be located on lands not subject to an existing Operating Agreement or existing Third Party JOA. Each Party must make its election of whether or not it will participate in the drilling of a proposed well by notice within thirty (30) days after (or such shorter notice period as required because of a lease expiration, in accordance with the terms of the applicable Operating Agreement or the Third Party JOA, or contractual obligation) such Party has received an AFE from the proposing Party (or, if such proposed well is subject to a Third Party JOA
within such other time period as set forth in the applicable Third Party JOA). A Party failing to make an election to participate within thirty (30) days after such Party’s receipt of the AFE from the proposing Party (or such other time period as set forth in the applicable Third Party JOA), shall have elected not to participate in the proposed well. Notwithstanding the foregoing, until such time as Participant has expended the entire Carry Amount, Participant must participate in the drilling of the initial well in each Contract Area. Participant may elect to be a non-consenting party in accordance with the applicable Operating Agreement or Third Party JOA in any subsequent Wells in a Contract Area but shall remain obligated to pay the Promoted Well Costs for such Wells in accordance with Section 4.3.

4.2 Development Plan. Commencing on the Effective Date and extending until Participant expends the entire Carry Amount, the Parties hereby agree to conduct operations on the Properties in accordance with the Development Plan. The Parties may modify or amend the Development Plan by written agreement. In the event Eureka fails to conduct operations on the Properties in material accordance with the Development Plan, and such failure is not due to a Force Majeure, Participant shall have the right as its sole remedy to propose and operate such additional Wells (the “Participant Operated Wells”) as needed to attain and maintain the rig operating minimum set forth in the Development Plan and Eureka will diligently and in good faith assist Participant in acquiring drilling rigs on a timely basis in order to attain and maintain the minimum rig count for the Development Plan. The Parties agree that Participant shall be deemed to have become the operator of all Participant Operated Wells on a contract operator basis, with the understanding that Eureka shall resume operatorship of each Participant Operated Well upon first production upon completion of such well Through the Tanks.

4.3 Promoted Wells. Prior to total expenditure of the Carry Amount, Participant shall bear and pay, in good and immediately available funds, sixty percent (60%) of Eureka’s Proportionate Share of the Well Costs (“Promoted Well Costs”) incurred for each Well drilled on the lands within the Primary Acreage AMI (the “Promoted Wells”). Unless Participant has elected to be a non-consenting party in accordance with the terms hereof and the applicable Operating Agreement or Third Party JOA, in addition to the Promoted Well Costs, Participant shall pay its Proportionate Share of Well Costs for each Promoted Well. Participant shall pay both the Promoted Well Costs and its
Proportionate Share of Well Costs for each Promoted Well no later than the applicable time period set forth in the applicable Operating Agreement or Third Party JOA (the “Payment Date”). Participant’s obligation to pay Promoted Well Costs shall terminate at such time as the aggregate Promoted Well Costs paid by Participant equals the Carry Amount. For purposes of determining Promoted Well Costs for any Well, Eureka’s Working Interest in such Well shall initially be determined as of the date Participant receives the applicable AFE. Until such time as Participant has expended the entire Carry Amount, Eureka shall deliver to Participant no later than thirty (30) days after the end of each calendar quarter a statement showing the outstanding balance of the Carry Amount.

In the event that Participant fails to pay Promoted Well Costs for any Promoted Well by the respective Payment Date, Eureka may thereupon deliver to Participant a notice of Participant’s failure to pay, which notice shall set forth the amount of Promoted Well Costs that is past due and demand payment of such Promoted Well Costs within ten (10) days after Participant’s receipt of such notice. If Participant fails to pay the full amount of the past due Promoted Well Costs within such ten (10) day period (a “Nonpayment Event”), Participant shall reassign to Eureka, by the execution, acknowledgment and delivery of an assignment in recordable form with a warranty of title by, through and under Eureka, 100% of Participant’s interest in the Contract Area in which the applicable Promoted Well is located, SAVE AND EXCEPT, any existing wellbores located thereon in which Participant owns an interest (each a “Reassignment”). Each such Reassignment shall be free and clear of any Subsequently-Created Burdens and liens and encumbrances of any kind granted or created by Participant.

With respect to each Nonpayment Event, if Participant delivers a Reassignment to Eureka and pays the applicable Promoted Well Costs within sixty (60) days after the applicable Nonpayment Event, such failure will not constitute a Default. All Promoted Well Costs paid by Participant shall reduce the Carry Amount. As used herein, “Default” means (a) a failure to cure a Nonpayment Event as provided herein, or (b) the occurrence of more than three (3) Nonpayment Events during any twelve (12) month period after the date hereof. On the occurrence of a Default, Eureka shall be entitled to exercise any and all rights available at law or in equity including, without limitation, specific performance of this Agreement and Eureka will be
entitled by notice to Participant to immediately suspend some or all of the obligations of Eureka under this Agreement, including without limitation the obligation to offer Participant its AMI Share of any Subsequently-Acquired Interests.

Except as set forth in this Section 4.3, Eureka and Participant shall each bear and pay their Proportionate Share of any other costs and expenses associated with a Promoted Well or any other Well in accordance with the terms of this Agreement and the applicable Operating Agreement or Third Party JOA, including any elections thereunder.

4.4 Post Carry Election Not to Participate in a Well. As between the Parties, after Participant has expended the entire Carry Amount, if any Party elects not to participate (or is deemed to have elected to not participate) in the drilling of the initial Well in any Contract Area, such non-participating Party shall relinquish, surrender and assign to the proposing Party all of its right, title and interest in the applicable Well and the Contract Area in which the applicable Well is located and its right to participate in the acquisition of Leases within the applicable Contract Area. Each such assignment shall be free and clear of any Subsequently-Created Burdens and liens and encumbrances granted or created by, through or under the non-participating Party.

4.5 Well Proposals by Participant. In the event Participant elects to renew or extend a Renewal or Extension Lease in which Eureka does not renew or extend its AMI Share, Participant shall have the right to propose and operate Wells on such Renewal or Extension Lease.

ARTICLE V OPERATIONS

5.1 Operator. As between the Parties and subject to Sections 4.2 and 4.5 and the terms of the applicable Operating Agreement or Third Party JOA, (a) Eureka shall have the right and obligation to be the operator for all operations conducted pursuant to this Agreement within the Primary Acreage AMI, (b) the Acquiring Party shall have the right to be the operator for all operations conducted within the Secondary Acreage AMI, and (c) where Eureka is the Acquiring Party, Eureka shall be the operator. Until the date that Participant has expended the entire Carry Amount, Participant shall vote for Eureka or the Acquiring Party, as applicable, in any vote with respect to becoming
or remaining as operator under the Operating Agreements and Third Party JOAs.

5.2 Operating Agreements.

(a) Prior to the commencement of each Well, if such Well is not already subject (as of the date such Well is proposed) to an existing Operating Agreement or a Third Party JOA, then (i) Operator shall prepare, execute and deliver to each Party duplicate copies of an Operating Agreement contemporaneously with the provision of the applicable AFE for such Well and (ii) each Party that participates in such Well shall execute such Operating Agreement. In the event that all of the Parties do not agree to the proposed Contract Area, Operator shall determine, in its reasonable discretion, the Contract Area under such Operating Agreement.

(b) In the event that any Jointly-Owned Leases within the AMI are subject to a Third Party JOA and two or more Parties jointly own all of the undivided working interests within the Contract Area of such Third Party JOA, the Parties shall promptly terminate such Third Party JOA and execute, in accordance with Section 5.2(a) above, an Operating Agreement covering such Contract Area.

(c) Except as expressly provided in this Agreement, (i) all Wells shall be proposed and governed by the terms of the applicable Operating Agreement or Third Party JOA and (ii) all elections and notices thereof shall be conducted as provided in the applicable Operating Agreement or Third Party JOA.

(d) To the extent that the provisions of an Operating Agreement or a Third Party JOA conflict with the provisions of this Agreement, then solely between the Parties, the provisions of this Agreement shall govern and control.
5.3 **Meetings.** The Parties shall establish an operating committee of three representatives from each of Participant and Eureka (the "Operating Committee"). Until such time as Participant has expended the entire Carry Amount, the Operating Committee shall meet no later than the fifteenth day after the end of each calendar quarter. After the Participant has expended the entire Carry Amount, the Operating Committee shall meet no later than the fifteenth day after the first and third calendar quarter of each year. Each meeting of the Operating Committee shall be held in Dallas, Texas, or at such other location as mutually agreed to by the Parties. Each meeting shall be for the purpose of conducting a review of the exploration, development and operation of the lands within the AMI including, without limitation, lease operating costs, projected lease operating costs, capital expenditures, a comparison of actual costs and expenditures to the amounts budgeted therefor, technical issues, and the plans, drilling schedule and budgets for the remainder of the applicable calendar year. In the Operating Committee meeting held in the last calendar quarter of each year, the Parties shall review and discuss the proposed Annual Budget for the immediately following year.

Not later than thirty (30) days prior to each scheduled Operating Committee meeting, Eureka shall provide to Participant, Eureka’s proposals with respect to the plans and drilling schedules to be discussed at such meeting. Participant may, within fifteen (15) days of receipt of any such proposal, provide comments to such proposal for the Operating Committee’s consideration. At each Operating Committee meeting, the Operating Committee shall devise a plan of exploration, development and operation of the lands within the AMI for the months remaining in the applicable calendar year; provided that if the Operating Committee is unable to reach an agreement on such plan, Eureka shall determine, in its sole discretion, the plan for such period. Each meeting of the Operating Committee may include a look back review of actual performance versus budgeted performance and actual performance versus the last quarterly forecast; a forecast of future performance through the end of the current year as well as a forecast of the following year beginning in the third and fourth quarter reviews; and a comparison of the forecast performance to current year budgeted performance.

In addition to the regularly scheduled meetings of the Operating Committee described in this Section 5.3, either Party may, at any time and
from time to time upon no less than fifteen (15) days advance notice, call a special meeting of the Operating Committee for any reasonable purpose; provided, however, that such Party must provide the other Party and the Operating Committee with an agenda at least ten (10) days in advance of such special meeting; provided further that no Party may call more than two special meetings in any calendar year.

5.4 Budgets. No later than thirty (30) days prior to the Operating Committee meeting to be held in the fourth calendar quarter of each year, Eureka shall prepare and deliver a budget for the immediately following calendar year, setting forth estimated future costs and expenses for drilling and completion of Wells to be drilled during such year (the “Annual Budget”). Each Annual Budget shall include the following information: general and administrative costs, base production and expected decline, operating costs in aggregate dollars and $/mcf, exploration and development capital expenditures, number and timing of drilled wells, forecast of midstream operations (including forecast interconnections, potential bottlenecks or gas sales constraints), production build (initial production, annual average production, and exit rate (December) production), environmental/regulatory/abandonment spending, environmental and regulatory compliance measures to be determined. The Annual Budget is subject to Participant’s and Participant’s approval, such approval not to be unreasonably withheld and may be modified from time to time by the agreement of the Parties. The Annual Budget shall be for informational purposes only.

5.5 Delay Rentals, Royalties and Shut-In Royalties.

(a) Subject to subsection (c) below, Operator shall pay, promptly and timely, each delay rental, shut-in payment, royalty and other lease payments that are necessary to maintain the Jointly-Owned Leases in effect. Subject to Section 8.2, Operator shall not be liable to any other Party for any inadvertent act or omission pertaining to the performance of its obligations under this Section 5.5 (including, without limitation, the decision to deduct or not deduct post-production expenses) or any loss resulting therefrom unless such act or omission constitutes gross negligence or willful misconduct by Operator.
(b) Operator shall, at least sixty (60) days before any delay rental shall become due, provide the other Parties with its written recommendation as to whether any such payment should be made. Operator shall invoice each Party for such Party’s Proportionate Share of such payments, and subject to subsection (c) below, each Party shall pay any such invoice within thirty (30) days of such Party’s receipt of such invoice.

(c) Should any Party fail to pay its Proportionate Share of such delay rentals as provided for in Section 5.5(b), the non-paying Party shall no longer have an interest in the applicable Lease and shall immediately assign all of such Party’s interest in the applicable Lease to those Parties who paid their Proportionate Share of the delay rentals. Such Lease shall no longer constitute a Jointly-Owned Lease and shall be deemed to have been removed from the terms of this Agreement. Those Parties who paid the delay rentals as provided for in Section 5.5(b) shall account to each other such that each has paid its Proportionate Share of the delay rentals after subtracting the interest in the Lease formerly held by the non-paying Party.

5.6 3-D Seismic Survey. Operator shall exclusively manage and conduct the acquisition of any Geoscientific Data, the performance of all 3-D seismic surveys and other geoscientific work incident to the transactions contemplated herein. Each Party will pay its Proportionate Share of the out-of-pocket costs and expenses incurred in acquiring, licensing, generating, processing, working and interpreting any Geoscientific Data and each Party will own its Proportionate Share of such Geoscientific Data. With respect to any Geoscientific Data acquired after the date hereof, Operator will give notice to all Parties that it is acquiring such Geoscientific Data and upon notice, assist any Party in its efforts to be named as a licensee; provided that if, notwithstanding such assistance, under the terms of the applicable license or agreement (except to the extent a Party has acquired a license therefor),
only one Person can be named as licensee, Operator will be named as licensee. No Party other than Operator will have any rights of ownership in any Geoscientific Data that is non-transferable under the terms of the applicable license or agreement; provided, however, that, to the extent not expressly prohibited by the terms of the applicable license or agreement, each such other Party shall be entitled, after reasonable notice to Operator, to review such Geoscientific Data and material during normal business hours in Operator’s offices. In addition, Operator will cooperate with each other Party, without any obligation to expend money, if such other Party wishes to obtain the right to use or own any such Geoscientific Data. In the event all or part of any Geoscientific Data developed by the Parties hereunder is licensed to an unaffiliated third Person, each Party shall be entitled to its Proportionate Share of the proceeds associated with such license.

5.7 Independent Contractor. In performing its duties under this Agreement, Operator shall serve as an independent contractor and not as an agent or employee of any other Party. Operator shall perform its duties under this Agreement as a reasonable, prudent operator, in a good and workmanlike manner with due diligence. No Party to this Agreement shall have any fiduciary relationship with the other Parties in regard to any leasehold interest and this Agreement. The liabilities of the Parties hereto shall be several and not joint or collective. It is not the purpose or intention of the Parties hereto to create any partnership, joint venture, mining partnership, association or fiduciary or any other special relationship among the Parties (whether legal or quasi-legal) whereby one Party is held liable for the acts or omissions of any of the other Parties, and neither this Agreement, the Operating Agreements, the Third Party JOAs nor the operations conducted hereunder shall be construed or considered as creating any such relationship. Without expanding any obligations which Operator may have to the other Parties, it is expressly agreed that Operator shall never have any liability to the other Parties with respect to operations of the properties subject to this Agreement greater than that which it might have as the operator to a non-operator under the applicable Operating Agreement or Third Party JOA (or in the absence of such an agreement, under the AAPL 610 (1989 Revision) form Operating Agreement), AND AS AN OPERATOR OR NON-OPERATOR SHALL NOT BE RESPONSIBLE TO THE OTHER PARTIES FOR OPERATOR’S NEGLIGENCE, AND EACH OTHER PARTY ACKNOWLEDGES THAT OPERATOR HAS NO RESPONSIBILITY FOR OPERATOR’S
ARTICLE VI
LEASE ACQUISITIONS and AREA OF MUTUAL INTEREST

6.1 Management of Lease Acquisition. Operator shall (i) consult with the other Parties to designate areas within the AMI in which the Parties desire to acquire Leases and (ii) be primarily responsible for the acquisition of Leases within the AMI, both in the field and administratively, using reasonable business judgment for the benefit of the Parties hereunder. Participant shall not acquire any Lease within the AMI without first consulting with Operator regarding the area in which Participant intends to acquire such Lease.

6.2 Acquisition of AMI Interest.

(a) During the AMI Term, when any Party or any Affiliate of any Party (the “Acquiring Party”) acquires or obtains any rights to any Subsequently-Acquired Interest, each other Party (each a “Non-Acquiring Party”) shall have the right, on an exclusive basis, to acquire its AMI Share of any AMI Interests included therein upon the terms set forth in this Article VI. Notwithstanding the foregoing, no Party shall have any right to acquire its AMI Share in any Subsequently-Acquired Interest within a Contract Area for which Participant has forfeited its rights to participate pursuant to Sections 4.3 and 4.4.

(b) For the purposes of this Article VI, if any AMI Interest that comprises a Subsequently-Acquired Interest covers lands that are both within and outside of the AMI, the Acquiring Party shall only be obligated, in accordance with the provisions of this Agreement, to offer to the Non-Acquiring Parties the portion of the AMI Interest located within the AMI (each a “Partitioned Interest”) at the Fair Market Value of the AMI Interests located within the
AMI. In such event, the Acquiring Party shall in good faith provide the Non-Acquiring Parties with a reasonable and supportable allocation of the Fair Market Value attributable to the Partitioned Interest. Each Non-Acquiring Party’s right hereunder to elect to acquire any AMI Interests shall be limited to lands located within the AMI.

(c) In the event an AMI Notice includes a Farmout entered into by an Acquiring Party, the Non-Acquiring Parties shall have the separate right (but not the obligation) to acquire their AMI Share in said Farmout, to join in performance of the terms thereof and to earn their AMI Share in the Subsequently-Acquired Interest acquired thereby if the Non-Acquiring Parties elect to do so within thirty (30) days after receipt of the AMI Notice (and a failure to respond within said time shall be deemed an election not to so acquire). If a Non-Acquiring Party elects or is deemed to have elected not to acquire its AMI Share in a Farmout under this Section 6.2(c), the Non-Acquiring Party shall have no right, title or interest in and to any Subsequently-Acquired Interest or other rights which may be earned under such Farmout. If the Non-Acquiring Party elects to acquire its AMI Share in a Farmout, each Non-Acquiring Parties shall be deemed to have assumed (i) the obligation to pay its AMI Share of the actual cost and expenses of any operation performed in order to earn the leases under the Farmout; (ii) the obligation to pay its AMI Share of any cash sums which are or become due and payable under the Farmout; and (iii) its AMI Share of all other obligations under such Farmout. If the Non-Acquiring Party elects to acquire its AMI Share in a Farmout under this Section 6.2(c), sums paid by the Acquiring Party described under clauses (i) or (ii) above shall be reimbursed to the Acquiring Party within ten (10) days after invoice. In the event the Non-Acquiring Parties
fail to timely pay any amounts due under clauses (i), (ii) or (iii) above, the Acquiring Party may elect, after giving the Non-Acquiring Party at least ten (10) days’ notice, at any time after such failure to pay and prior to receipt of payment to treat the Non-Acquiring Party as if it had elected not to acquire the Farmout interest under this Section 6.2(c), in which event the Non-Acquiring Parties shall have no right, title or interest in and to any Subsequently-Acquired Interest that may be earned under the applicable Farmout. In the event the Acquiring Party fails to timely pay any amounts due under clauses (i), (ii) or (iii) above, the Non-Acquiring Parties shall have the right by notice to the Acquiring Party to assume all of the Acquiring Party’s rights and obligations under the Farmout. If a Farmout is acquired under which the drilling of any well is optional and the Non-Acquiring Parties elects not to join in the drilling of such well, then all Subsequently-Acquired Interest that may be earned (including rights to drill subsequent wells and earn additional Subsequently-Acquired Interest) by the drilling of such well shall be relinquished to the Acquiring Party at such time as the earning well is drilled by the Acquiring Party. The Parties that have participated in the drilling of a well under a Farmout but which elect not to participate in a completion attempt shall be entitled to participate and acquire their respective interests in the Leases earned by the drilling of such well, but such Parties and their interests in the Leases earned shall be subject to the penalties provided in the applicable Operating Agreement or Third Party JOA or other comparable provisions of such Operating Agreement or Third Party JOA without regard to whether the Farmout is on a drill-to-earn or produce-to-earn basis.
6.3 Notification.

(a) With respect to the Subsequently-Acquired Interests arising from the Effective Date to the date of this Agreement, Eureka shall concurrently with the execution of this Agreement notify the Participant of the acquisition of such Subsequently-Acquired Interests.

(b) At all times after the date of this Agreement, with respect to each individual Subsequently-Acquired Interest that has a Fair Market Value greater than two hundred fifty thousand dollars ($250,000.00), the applicable Acquiring Party shall notify the Non-Acquiring Parties of the acquisition of such Subsequently-Acquired Interest at least ten (10) days prior to the acquisition.

(c) At all times after the date of this Agreement, with respect to each individual Subsequently-Acquired Interest that has an individual or aggregate Fair Market Value less than or equal to two hundred fifty thousand dollars ($250,000.00), no later than ninety (90) days after the end of the calendar month in which such Subsequently-Acquired Interest was acquired by the applicable Acquiring Party, such Acquiring Party shall notify the Non-Acquiring Parties in writing of the acquisition of each such Subsequently-Acquired Interest.

(d) Each notice delivered under this Section 6.3 (each an “AMI Notice”) shall set forth (i) complete and correct copies of all Underlying Agreements, (ii) the purchase price or other consideration to be paid or paid for the AMI Interests included in such Subsequently-Acquired Interest, (ii) a copy of the broker’s report, abstract, or other title information in its possession or control, if any, covering
the AMI Interests included in such Subsequently-Acquired Interest, (iii) to the extent the Underlying Agreements related to a Partitioned Interest, the Acquiring Party’s good faith reasonable and supportable allocation of the Fair Market Value attributable to the Partitioned Interest, (iv) the extent of the projected oil and gas reserves, if any, with respect to developed AMI Interests included within such Subsequently-Acquired Interest, (v) evidence of the payment, if any, for the AMI Interests included in such Subsequently-Acquired Interest, (vi) to the extent the Acquiring Party acquired the Subsequently-Acquired Interest in a Corporate Acquisition, the Acquiring Party’s good faith reasonable and supportable determination of the Fair Market Value of such Subsequently-Acquired Interest, and (vii) an invoice for the Non-Acquiring Parties’ AMI Share of (A) for any acquisition other than a Corporation Acquisition, the total cost of the AMI Interests included in the Subsequently-Acquired Interest, including all Lease Acquisition Costs associated therewith or (B) for any Corporate Acquisition, the Fair Market Value of the Subsequently-Acquired Interest. Thereafter, as additional information becomes available, the Acquiring Party shall promptly deliver such information to the Non-Acquiring Parties.

6.4 Election Period.

(a) Each Non-Acquiring Party shall have the right, but not the obligation, to elect to acquire its AMI Share of the AMI Interests included in any Subsequently-Acquired Interest by delivering to the Acquiring Party a notice of such election on or prior to thirty (30) days after the receipt from the Acquiring Party of an AMI Notice that satisfies the requirements set forth in Section 6.3(d).
(b) If a Non-Acquiring Party validly elects to acquire its AMI Share of the AMI Interests included in a Subsequently-Acquired Interest, such Non-Acquiring Party’s election shall constitute a binding and enforceable, non-revocable obligation by such Non-Acquiring Party to participate in the AMI Interests included in such Subsequently-Acquired Interest upon and subject to the terms set forth in the applicable AMI Notice.

(c) Promptly upon the delivery by such Non-Acquiring Party of a valid election notice with respect to such Subsequently-Acquired Interest, such Non-Acquiring Party shall pay to the Acquiring Party an amount equal to the sum of such Non-Acquiring Party’s AMI Share of the total cost of the AMI Interests included in the Subsequently-Acquired Interest, including all Lease Acquisition Costs associated therewith.

(d) If a Non-Acquiring Party fails to validly elect in writing to acquire its AMI Share of any Subsequently-Acquired Interest and pay its AMI Share of the total cost therefor, such Non-Acquiring Party shall be deemed to have elected not to acquire its AMI Share of the Subsequently-Acquired Interest. The Acquiring Party shall be entitled to proceed with the acquisition of such Subsequently-Acquired Interest for a period of ninety (90) days after the Non-Acquiring Party has elected not to participate in such acquisition (or is deemed to have so elected) upon substantially the same terms as those set forth in the applicable AMI Notice. If the Acquiring Party fails to close on the purchase of the Subsequently-Acquired Interest within such ninety (90) day period, then the Acquiring Party shall be obligated to deliver an additional AMI Notice to the Non-Acquiring Party pursuant to Section 6.3(d) and the Non-Acquiring
Party shall have an additional opportunity to elect whether or not to acquire its AMI Share of such Subsequently-Acquired Interest.

6.5 Renewal or Extension Leases. If an Acquiring Party desires to renew or extend a Jointly-Owned Lease (a “Renewal or Extension Lease”), each Non-Acquiring Party shall have the right to renew or extend its AMI Share thereof. The Acquiring Party shall promptly notify each Non-Acquiring Party of such proposed renewal or extension. Each such notification shall include (i) the total Lease Acquisition Cost for such Renewal or Extension Lease, (ii) a copy of the Renewal or Extension Lease and (iii) any other information reasonably requested by the Non-Acquiring Parties. Each Non-Acquiring Party shall have thirty (30) days after the receipt of such notice to elect to renew or extend its AMI Share of the Renewal or Extension Lease. Such election shall be given in writing to the Acquiring Party, together with payment of the Non-Acquiring Party’s AMI Share of the total Lease Acquisition Cost for such Renewal or Extension Lease. If a Non-Acquiring Party does not deliver such notice and its AMI Share of the Lease Acquisition Cost for such Renewal or Extension Lease within such thirty-day period, such Non-Acquiring Party conclusively shall have elected not to renew or extend its AMI Share of the Renewal or Extension Lease. If not all of the Parties elect to renew or extend their AMI Shares of any Renewal or Extension Lease, such Renewal or Extension Lease shall no longer constitute a Jointly Owned Lease with respect to the Non-Acquiring Parties that elected not to renew or extend their AMI Share of such Renewal or Extension Lease. For the purposes of this provision, the term “Renewal or Extension Lease” shall mean any Lease that is renewed or extended before the expiration of a prior Jointly-Owned Lease or taken or contracted within one (1) year from the expiration of a Jointly-Owned Lease covering such mineral interests to the extent such Lease is located within the AMI.

6.6 Title to Leasehold Rights. An Acquiring Party shall hold legal title as lessee to all AMI Interests included in a Subsequently-Acquired Interest acquired by such Acquiring Party. On or about March 1, June 1, September 1 and December 1 of each year, provided that a Non-Acquiring Party has timely paid its AMI Share of the total cost for the Subsequently Acquired Interests accrued during the immediately preceding three month period, the Acquiring Party shall execute and deliver to such Non-Acquiring Party an appropriate
assignment, without warranty or representation other than a warranty of title by, through and under such Acquiring Party, in a form substantially similar to that attached hereto as Exhibit J (each an “Assignment”). Each Assignment shall be made expressly subject to (and each Party shall assume its AMI Share of all obligations and liabilities subsequently arising under) the terms and provisions of (a) the Underlying Agreements with respect to such AMI Interests included in such Subsequently-Acquired Interests and any intervening transfers thereof up to the time of acquisition by the Acquiring Party, (b) all contracts applicable to such Subsequently-Acquired Interests, (c) this Agreement, and (d) the applicable Operating Agreement or Third Party JOA. Notwithstanding the foregoing, in the event the Fair Market Value of any Subsequently-Acquired Interest exceeds $1,000,000.00, concurrently with the Acquiring Party’s acquisition of such Subsequently-Acquired Interest, the Acquiring Party shall execute and deliver an Assignment to each Non-Acquiring Party that has paid, or concurrently with such acquisition pays, its AMI Share of the total cost of the AMI Interests included in the Subsequently-Acquired Interest.

6.7 Existing Burdens. Each Party’s interest in the Subsequently-Acquired Interests acquired pursuant to the terms of this Section, shall be subject to and burdened by its AMI Share of all Lease Burdens other than Subsequently-Created Burdens. Each Party hereby represents and warrants to the other Parties that (a) Exhibit “H” attached hereto sets forth immediately under the applicable section of such Exhibit “H” for such Party a list of all contracts and agreements existing as of the Closing that contain provisions that obligate or require such Party or any of its Affiliates to grant or impose Lease Burdens on any AMI Interests included in any Subsequently-Acquired Interests that would burden a Non-Acquiring Party’s AMI Share of such AMI Interests and (b) true and correct copies of all such contracts and agreements have been provided by such Party to the other Parties hereto.

6.8 Affiliates. In the event that the Acquiring Party is an Affiliate of any Party, the Party for which the Acquiring Party is an Affiliate shall cause such Affiliate to comply with the terms of this Agreement.

6.9 AMI Term. The provisions set forth in this Article VI shall be effective as of April 1, 2010 and shall remain binding and in force and effect (a) as to each Party, until five (5) years from the date hereof, and (b) as to each
Affiliate of each Party, until the earlier to occur of (i) five (5) years from the
date hereof and (ii) the date that such Person is no longer an Affiliate of any
Party that is bound by and subject to this Article VI (the “AMI Term”). All
AMI Interests arising during or relating to the AMI Term shall be subject
to this Agreement.

6.10 Excluded Transactions. Except as expressly set forth herein (a) any
Party or its Affiliate may engage in or possess an interest in other business
ventures of any nature or description, independently or with others, similar
or dissimilar to the business of any other Party, and none of the Parties or
their respective Affiliates or officers shall have any rights by virtue of this
Agreement in and to such independent ventures or the income or profits
derived therefrom, and the pursuit of any such venture, even if competitive
with the business of any other Party, shall not be deemed wrongful or
improper, and (b) no Party or its Affiliates or officers shall be obligated to
present any particular investment opportunity to any other party even if such
opportunity is of a character that, if presented to the Non-Acquiring Parties,
could be taken by the Non-Acquiring Parties, and any Party, its Affiliates
and officers shall have the right to take for its own account (individually or
as a partner, shareholder, fiduciary or otherwise) or to recommend to others
any such particular investment opportunity.

ARTICLE VII
ACCOUNTING ADJUSTMENTS

7.1 Adjustments for Revenue and Expenses. Appropriate adjustments to
the Carry Amount shall be made between Participant and Eureka so that:

(a) Participant will bear all expenses which are incurred in the
operation of the Participant’s Share of the Properties on
or after the Effective Date, including, without limitation,
all drilling costs, all capital expenditures, all overhead
charges under applicable operating agreements (regardless
of whether such operating agreements are with Third
Parties or related entities and regardless of whether Eureka
is the operator or a non-operator), all other overhead
charges actually charged by Third Parties, and Participant
will receive all proceeds (net of applicable production,
severance, and similar taxes) from sales of oil, gas and/or other minerals which are produced from (or attributable to) Participant’s Share of the Properties and which are produced on or after the Effective Date, and

(b) except as provided in Section 7.4 below, Eureka will bear all expenses which are incurred in the operation of the Properties before the Effective Date and Eureka will receive all proceeds (net of applicable production, severance, and similar taxes) from the sale of oil, gas and/or other minerals which were produced from (or attributable to) the Properties and which were produced before the Effective Date.

(c) It is agreed that, in making such adjustments:

(i) oil which was produced from the Properties and which was, on the Effective Date, stored in tanks located on the Properties (or located elsewhere but used by Eureka to store oil produced from, or attributable to, the Properties prior to delivery to oil purchasers) and above pipeline connections shall be deemed to have been produced before the Effective Date;

(ii) ad valorem and similar Taxes assessed for periods prior to the Effective Date shall be borne by Eureka and Participant’s Share of the ad valorem taxes assessed for periods on or after the Effective Date, including taxes prepaid by Eureka, shall be borne by Participant;

(iii) ad valorem and similar taxes assessed with respect to a period which the Effective Date splits shall be prorated based on the number of days in such period which fall on each side of the Effective Date.
Date (with the day on which the Effective Date falls being counted in the period after the Effective Date); and

(iv) no consideration shall be given to the local, state or federal income tax liabilities of any Party.

7.2 Initial Adjustment at Closing. Eureka shall provide to Participant a statement (the “Initial Settlement Statement”) showing its computations of the amount of the adjustments provided for in Section 7.1 based on amounts which prior to such time have actually been paid or received by Eureka. If the amount of adjustments so determined which would result in a credit to Participant exceed the amount of adjustments so determined which would result in a credit to Eureka, the Carry Amount shall be reduced by the amount of such excess, and if the converse is true, then, the Carry Amount shall be increased by the amount of such excess.

7.3 Adjustment Post Closing. On or before 120 days after the date of this Agreement, Eureka shall prepare a “Final Settlement Statement” and deliver same to Participant setting forth any additional adjustments to the Carry Amount not reflected in the Initial Settlement Statement. Participant will assist Eureka in the preparation of the Final Settlement Statement by providing Eureka with any data or information reasonably requested by Eureka. The Final Settlement Statement shall become final and binding upon the Parties on the thirtieth (30th) day following receipt thereof by Participant, unless Participant gives notice of its disagreement to Eureka prior to such date. In order to be valid, any such notice shall specify in reasonable detail the dollar amount, nature and basis of any disagreement so asserted. If the amount of the Carry Amount as set forth on the Final Settlement Statement exceeds the amount of the adjusted Carry Amount determined at the execution of this Agreement, then the Carry Amount will be increased by the amount by which the Carry Amount as set forth on the Final Settlement Statement exceeds the amount of the adjusted Carry Amount determined at the execution of this Agreement. If the amount of the Carry Amount as set forth on the Final Settlement Statement is less than the amount of the adjusted Carry Amount determined at the execution of this Agreement, then the Carry Amount shall be reduced by the amount by which the Carry Amount as set forth on the Final Settlement Statement is less
than the amount of the adjusted Carry Amount determined at the execution of this Agreement.

7.4 No Further Adjustments. Following the adjustments under Section 7.3, no further adjustments shall be made under this Article VII. Should any expenses with regard to Participant’s Share of the Properties be charged to (or received by) Eureka or Participant after the earlier of (i) the conclusion of such adjustments under Section 7.3 or (ii) 120 days after the execution of this Agreement, Participant’s Share of the same shall be borne by Participant, regardless of the periods to which the same relate, and any bills received by Eureka will be forwarded to Participant.

ARTICLE VIII
ASSUMPTION AND INDEMNIFICATION

8.1 Assumption and Indemnification By Participant. From and after the date hereof, subject to Participant’s rights and remedies under Section 8.2 and without limiting such rights and remedies and not including any Participant Indemnified Claim for which Participant is indemnified under Section 8.2, Participant shall assume, indemnify, defend and hold Eureka (and its Affiliates and their respective successors and assignors and their respective owners, directors, officers and employees) harmless from and against any and all claims, actions, causes of action, liabilities, losses, damages, fines, penalties, costs or expenses (including, without limitation, court costs and consultants’ and attorneys’ fees) of any kind or character (individually a “Eureka Indemnified Claim” and collectively “Eureka’s Indemnified Claims”) to the extent arising from or related to:

(a) any misrepresentation or breach of any representation or warranty of Participant contained in this Agreement;

(b) any breach of any covenant or agreement of Participant contained in this Agreement; or

(c) any Title Defect, with respect to Participant’s Share of the Properties, except for any right or remedy of Participant under Section 3.4 for such Title Defect.
THE FOREGOING ASSUMPTIONS AND INDEMNIFICATIONS OF PARTICIPANT SHALL APPLY WHETHER OR NOT SUCH DUTIES, OBLIGATIONS OR LIABILITIES, OR SUCH CLAIMS, ACTIONS, CAUSES OF ACTION, LIABILITIES, DAMAGES, LOSSES, COSTS OR EXPENSES ARISE OUT OF (i) NEGLIGENCE (INCLUDING SOLE NEGLIGENCE, SIMPLE NEGLIGENCE, CONCURRENT NEGLIGENCE, ACTIVE OR PASSIVE NEGLIGENCE, BUT EXPRESSLY NOT INCLUDING GROSS NEGLIGENCE OR WILLFUL MISCONDUCT) OF ANY INDEMNIFIED PARTY, (ii) STRICT LIABILITY, OR (iii) ANY VIOLATION OF ANY LAW, RULE, REGULATION OR ORDER RELATED TO THE OWNERSHIP OR OPERATION OF THE PROPERTIES, INCLUDING APPLICABLE ENVIRONMENTAL LAWS.

8.2 Indemnification By Eureka. From and after the date hereof, Eureka shall defend, indemnify and hold Participant (and its Affiliates and their respective successors and assigns and all their respective owners, directors, officers, and employees) harmless from and against any and all claims, actions, causes of action, liabilities, losses, damages, fines, penalties, costs or expenses (including without limitation court costs and consultants and attorneys fees) (individually a “Participant’s Indemnified Claim” and collectively “Participant’s Indemnified Claims”) to the extent arising out of:

(a) any misrepresentation or breach of any representation or warranty of Eureka contained in this Agreement;

(b) any breach of any covenant or agreement of Eureka contained in this Agreement;

(c) the ownership and/or operation of the Properties prior to the Effective Date; and

(d) any taxes due and owing with respect to the Properties for periods prior to the Effective Date.
The foregoing assumptions and indemnifications of Eureka shall apply whether or not such duties, obligations or liabilities, or such claims, actions, causes of action, liabilities, damages, losses, costs or expenses arise out of (i) negligence (including sole negligence, simple negligence, concurrent negligence, active or passive negligence, but expressly not including gross negligence or willful misconduct) of any indemnified party, (ii) strict liability, or (iii) any violation of any law, rule, regulation or order related to the ownership or operation of the properties, including applicable environmental laws.

Notwithstanding anything to the contrary herein, it is expressly understood that Eureka shall not have any obligation to defend, indemnify and hold harmless Participant (or its owners, directors, officers, and employees) (a) with respect to any Eureka's Indemnified Claims, or (b) with respect to any Participant Indemnified Claims except to the extent that the aggregate Indemnified Claims exceed One Million Dollars ($1,000,000.00). It being expressly understood that Eureka not have any such indemnity and hold harmless obligation for the first One Million Dollars ($1,000,000.00) of the aggregate Indemnified Claims and that the $1,000,000.00 is a deductible.

8.3 Survival of Provisions. The representations and warranties set out in Exhibit “G” shall survive for a period of twelve (12) months except that representations and warranties as to matters that could constitute Title Defects shall not survive. All covenants of Eureka or Participant contained in this Agreement shall survive indefinitely except for (a) any covenant which by its terms terminates as of a specific date, or is only made for a specified period, and (b) the covenants set forth in Sections 8.1(a) and 8.2(a), which shall only survive for a period of twelve (12) months, provided that to the
extent any representation or warranty survives for a longer period of time the
covenants set forth in Sections 8.1(a) and 8.2(a) shall survive for such longer
period of time solely with respect to such representation and warranty (the
“Survival Period”). Notice of any claim by a Party seeking indemnification
from another Party under Section 8.1 or 8.2, as applicable, arising during
the Survival Period must be given by the Party seeking indemnification to
the indemnifying Party no later than the end of the Survival Period.

8.4 Notice of Claim. If indemnification pursuant to Section 8.1 or 8.2
is sought, the Party seeking indemnification (the “Indemnitee”) shall give
notice to the indemnifying Party of an event giving rise to the obligation to
indemnify, describing in reasonable detail the factual basis for such claim,
and shall allow the indemnifying Party to assume and conduct the defense
of the claim or action with counsel reasonably satisfactory to the Indemnitee,
and cooperate with the indemnifying Party in the defense thereof; provided,
however, that the omission to give such notice to the indemnifying Party shall
not relieve the indemnifying Party from any liability which it may have to the
Indemnitee, except to the extent that the indemnifying Party is prejudiced by
the failure to give such notice and as otherwise provided in Section 8.3. The
Indemnitee shall have the right to employ separate counsel to represent the
Indemnitee if the Indemnitee is advised by counsel that an actual conflict of
interest makes it advisable for the Indemnitee to be represented by separate
counsel and the reasonable expenses and fees of such separate counsel shall
be paid by the indemnifying Party.

8.5 No Commissions Owed. Eureka agrees to indemnify, defend and hold
Participant (and its Affiliates and their respective successors and assignors
and their respective owners, directors, officers and employees) harmless
from and against any and all claims, actions, causes of action, liabilities,
damages, losses, costs or expenses (including, without limitation, court costs
and attorneys fees) of any kind or character arising out of or resulting from
any agreement, arrangement or understanding alleged to have been made
by, or on behalf of, Eureka with any broker or finder in connection with this
Agreement or the transaction contemplated hereby. Participant agrees to
indemnify, defend and hold Eureka (and its Affiliates and their respective
successors and assignors and their respective owners, directors, officers and
employees) harmless from and against any and all claims, actions, causes
of action, liabilities, damages, losses, costs or expenses (including, without
limitation, court costs and attorneys fees) of any kind or character arising out of or resulting from any agreement, arrangement or understanding alleged to have been made by, or on behalf of, Participant with any broker or finder in connection with this Agreement or the transaction contemplated hereby.

**ARTICLE IX
REPRESENTATIONS AND WARRANTIES**

9.1 Representation of Eureka. Eureka represents and warrants to Participant as of the date hereof those representations and warranties set forth in Article 1 of Exhibit “G”.

9.2 Representation of Participant. Participant represents and warrants to Eureka as of the date hereof those representations and warranties set forth in Article 2 of Exhibit “G”.

**ARTICLE X
DISCLAIMER**

AND IN THEIR PRESENT CONDITION AND STATE OF REPAIR. WITHOUT LIMITING THE GENERALITY OF THE FOREGOING, EXCEPT FOR EUREKA’S EXPRESS WARRANTIES, EUREKA DOES NOT MAKE ANY REPRESENTATION OR WARRANTY AS TO (A) THE AMOUNT, VALUE, QUALITY, QUANTITY, VOLUME, OR DELIVERABILITY OF ANY OIL, GAS, OR OTHER MINERALS OR RESERVES IN, UNDER, OR ATTRIBUTABLE TO PARTICIPANT’S SHARE OF THE OIL AND GAS PROPERTIES, (B) THE PHYSICAL, OPERATING, REGULATORY COMPLIANCE, SAFETY, OR ENVIRONMENTAL CONDITION OF THE PROPERTIES, (C) THE GEOLOGICAL OR ENGINEERING CONDITION OF PARTICIPANT’S SHARE OF THE OIL AND GAS PROPERTIES OR ANY VALUE THEREOF OR (D) THE ACCURACY, COMPLETENESS, OR MATERIALITY OF ANY DATA, INFORMATION, OR RECORDS FURNISHED TO PARTICIPANT IN CONNECTION WITH EUREKA OR THE PROPERTIES. PARTICIPANT ACKNOWLEDGES AND AGREES TO THE FOREGOING AND THAT THE FOREGOING DISCLAIMER IS “CONSPICUOUS.”

ARTICLE XI
ASSIGNMENTS

11.1 Limitation on Assignments. Except as otherwise set forth below and subject to Section 11.2, each Party may assign, convey or otherwise transfer all or any part of its rights, interests or obligations under this Agreement or any of its rights or interests in the Wells or the Jointly-Owned Leases to an assignee or transferee (including any Affiliate of the transferring Party) who agrees in writing to assume, be bound by and fully and timely perform the terms of this Agreement, the applicable Operating Agreements, and Third Party JOAs. Except for transfers to its Affiliates described below, until Participant has expended the entire Carry Amount, Participant shall not have the right to assign this Agreement or any rights or obligations hereunder without the prior written consent of Eureka, which consent shall not be unreasonably withheld. It shall be reasonable for each Eureka to withhold its consent to assign this Agreement if Eureka believes in good faith that (i) such assignment would likely have a significant detrimental affect on Eureka or the operations to be conducted hereunder, (ii) the proposed assignee does not have the financial capability to meet prospective obligations arising out
of this Agreement, or (iii) such assignment would likely result in Eureka suffering a loss of operatorship for any reason, including without limitation, Eureka owning less than fifty percent (50%) of the aggregate working interest in the applicable area. Any attempted assignment by Participant absent such consent shall be void. If Eureka fails to deliver a written response to Participant’s written request for consent to assignment hereunder on or before thirty (30) days after receipt of such request, Eureka shall be deemed conclusively to have consented to such proposed assignment hereunder. Notwithstanding the foregoing, each Party shall be entitled to transfer this Agreement to an Affiliate without the consent of the other Parties, but the transferring Party shall remain liable for the performance of its obligations hereunder notwithstanding such transfer in the event of a default by such Affiliate hereunder.

11.2 Tag-Along Rights.

(a) In the event Eureka, or in the case of clause (i) immediately below, the shareholders of Eureka (in each case, the “Selling Party”), desires to sell or transfer to a Third Party (other than a sale or other disposition to another Party or to an Affiliate of the Selling Party, provided that such Affiliate shall become bound to this Agreement upon such sale or other disposition) either (i) equity in the Selling Party which would result in a Change of Control of such Selling Party or (ii) all or substantially all of its interests in the AMI (in either case, a “Third Party Transfer”), the Selling Party shall provide notice (a “Tag-Along Notice”) to the other Party (each a “Tag-Along Party”) at least thirty (30) days prior to the closing of such Third Party Transfer. Each Tag-Along Notice shall: (i) be accompanied by a copy of any agreement or term sheet relating to the Third Party Transfer, (ii) set forth the name of the transferee, the cash sales price, any additional consideration, and the terms and conditions of payment offered by the transferee, and (iii) specify the date such proposed sale is expected to be consummated.
(the “Tag-Along Sale Date”). Each Tag-Along Party shall notify the Selling Party, in writing, within ten (10) days of receipt of a Tag-Along Notice whether such Tag-Along Party desires to sell its interests in a proportionate part of its interests in the AMI to such transferee (i) if the Third Party Transfer will be a sale of all or substantially all of the Selling Party’s interests in the AMI, on the same terms and conditions of the Third Party Transfer, and (ii) if the Third Party Transfer will be a Change of Control, for reasonably equivalent value on terms and conditions substantially similar to those of the Third Party Transfer. The failure of a Tag-Along Party to timely deliver notice to the Selling Party shall be deemed a waiver by such Tag-Along Party of its right to sell its interests in the Third Party Transfer. If applicable, each Tag-Along Party shall promptly execute and return the final agreement to the Selling Party for closing. No Party shall have any fiduciary obligations or liabilities to any other Party in connection with any Third Party Transfer.

(b) If a Tag-Along Party declines to sell with the Selling Party, the Selling Party shall have the right to complete the Third Party Transfer without the participation of such Tag-Along Party, but only on terms and conditions (including price) that are no more favorable in any material respect to the Selling Party than as stated in the Tag-Along Notice and only if such proposed Third Party Transfer occurs on a date within sixty (60) days of the Tag-Along Sale Date. If the proposed Third Party Transfer does not occur within such sixty (60) day period, the Selling Party must deliver to each Tag-Along Party a Tag-Along Notice with respect to any Third Party Transfer proposed thereafter and each Tag-Along Party shall have a right to participate in such Third Party Transfer pursuant to the terms of this Section 11.2.
ARTICLE XII ADMINISTRATION OF UNDEVELOPED PROPERTIES AFTER THE TERM

12.1 Applicability of This Article. The provisions of this Article XII shall govern the administration of undeveloped Jointly-Owned Leases after the Term.

12.2 Delay Rentals, Royalties and Shut-In Royalties.

(a) Subject to subsection (c) below, Operator shall pay, promptly and timely, each delay rental, shut-in payment, royalty and other lease payments that are necessary to maintain the Jointly-Owned Leases in effect. Operator shall not be liable to any other Party for any inadvertent act or omission pertaining to the performance of its obligations under this Section 12.2 (including, without limitation, the decision to deduct or not deduct post-production expenses) or any loss resulting therefrom unless such act or omission constitutes gross negligence or willful misconduct by Operator.

(b) Operator shall, at least sixty (60) days before any delay rental shall become due, provide the other Parties with its written recommendation as to whether any such payment should be made. Operator shall invoice each other Party for such Party’s Proportionate Share of such payments, and subject to subsection (c) below, each Party shall pay any such invoice within thirty (30) days of such Party’s receipt of such invoice.

(c) Should any Party fail to pay its Proportionate Share of such delay rentals as provided for in Section 12.2(b), the non-paying Party shall no longer have an interest in the applicable Lease and shall immediately assign all of such Party’s interest in the applicable Lease to those Parties who paid their proportionate share of the delay rentals. Such Lease shall no longer constitute a Jointly-Owned Lease and
shall be deemed to have been removed from the terms of this Agreement. Those Parties who paid the delay rentals as provided for in Section 13.2(b) shall account to each other such that each has paid its Proportionate Share of the delay rentals after subtracting the interest in the Lease formerly held by the non-paying Party.

12.3 Well Proposals. For Jointly-Owned Leases not subject to an existing Operating Agreement or Third Party JOA, any Party may propose a Well and a related Contract Area. Each Party must make its election of whether or not it will participate in the drilling of such proposed Well by notice within thirty (30) days after (or such shorter notice period as required because of a lease expiration, in accordance with the terms of the applicable contractual obligation) such Party has received an AFE from the proposing Party. A Party failing to make an election to participate within thirty (30) days after such Party’s receipt of the AFE from the proposing Party, shall have elected not to participate in the proposed well. Prior to the commencement of the Well, (i) the Operator shall prepare, execute and deliver to the participating Parties duplicate copies of an Operating Agreement covering the applicable Contract Area and (ii) each Party that participates in such Well shall execute such Operating Agreement. Upon the execution and delivery of an Operating Agreement pursuant to this Section 12.3, the lands included within the Contract Area covered by such Operating Agreement shall no longer be subject to this Agreement, and the administration and operation of such lands shall be governed by the Operating Agreement.

12.4 Post Carry Election Not to Participate in a Well. As between the Parties, if any Party elects not to participate (or is deemed to have elected to not participate) in the drilling of the initial Well in any Contract Area, such non-participating Party shall relinquish, surrender and assign to the proposing Party all of its right, title and interest in the applicable Well and the Contract Area in which the applicable Well is located and its right to participate in the acquisition of Leases within the applicable Contract Area. Each such assignment shall be free and clear of any Subsequently-Created
Burdens and liens and encumbrances granted or created by, through or under such relinquishing Party.

12.5  **Excused Operator Obligations.** Notwithstanding anything herein to the contrary, to the extent that a Third Party JOA covers any portion of the interests included in the Properties or Subsequently-Acquired Interests and no Party hereto is designated as the “operator” under such Third Party JOA, then the obligations of Operator under Article XII (“Operator Obligations”) shall be subject to such Third Party JOA and, to the extent that such Third Party JOA requires or obligates the “operator” thereunder to perform any of the Operator Obligations with respect to the Properties or Subsequently-Acquired Interests subject to such Third Party JOA, then Operator shall not be required to perform such Operator Obligations to the extent such Third Party “operator” is required or obligated to perform such Operator Obligations.

**ARTICLE XIII**

**MISCELLANEOUS**

13.1  **Term and Applicability of Agreement.** The term of this Agreement (the “Term”) shall begin on the date hereof and, unless earlier terminated by written agreement of the Parties, shall continue until the fifth annual anniversary of the date hereof; provided that, prior to such fifth annual anniversary date and annually thereafter, the Parties may agree to extend the term of this Agreement yearly. Unless otherwise provided for in this Agreement, all covenants, agreements, rights and obligations of the Parties under this Agreement shall survive for the Term, provided, however, that the provisions of Sections 13.6, 13.8 and 13.17 shall survive termination of this Agreement for the applicable statute of limitations and the provisions of Article XII shall survive for so long as any Jointly-Owned Leases remain in effect and are not subject to an Operating Agreement or Third Party JOA shall survive the termination of this Agreement indefinitely. Any executed Operating Agreement shall survive the termination of this Agreement, unless such Operating Agreement shall have otherwise terminated in accordance with its terms.

13.2  **Time is of the Essence.** Time is of the essence in this Agreement.
13.3 Amendments; Waivers. This Agreement may be amended, modified, supplemented, restated or discharged (and provisions hereof may be waived) only by an instrument in writing signed by the Party against whom enforcement of the amendment, modification, supplement, restatement or discharge (or waiver) is sought.

13.4 Effect of Termination. Upon the end of the Term, no Party shall have any further rights or obligations hereunder, save and except (a) rights and obligations accruing prior to expiration of the Term and which remain unfulfilled or unperformed, (b) rights and obligations which are expressly provided in this Agreement to survive termination hereof or which by their very nature are performable only following expiration of the Term, (c) rights and remedies available to any Party resulting from a breach of this Agreement by any other Party prior to the end of the Term by another Party, and (d) rights and obligations under the Operating Agreements and the Third Party JOAs.

13.5 No Third-Party Beneficiaries. This Agreement is made solely for the benefit of those Persons who are Parties (including those Persons succeeding to all or part of the interest of an original party if such succession is recognized under the other provisions hereof), and no other Person shall have or claim or be entitled to enforce any rights, benefits or obligations under this Agreement.

13.6 Choice of Law, etc.

(a) Without regard to principles of conflicts of law, this Agreement shall be construed and enforced in accordance with and governed by the laws of the state of Texas applicable to contracts made and to be performed entirely within such state and the laws of the United States of America, except that, to the extent that the law of a state in which a portion of the Properties or Subsequently-Acquired Interests is located (or which is otherwise applicable to a portion of the Properties or Subsequently-Acquired Interest) necessarily governs, the law of such state shall apply as to that portion
of the Property or Subsequently-Acquired Interest located in (or otherwise subject to the laws of) such state.

(b) Each Party agrees that the appropriate, exclusive and convenient forum for any disputes between any of the Parties arising out of this Agreement or the transactions contemplated hereby shall be in any state or federal court in Houston, Texas, and each of the Parties irrevocably submits to the jurisdiction of such courts solely in respect of any legal proceeding arising out of or related to this Agreement or the transactions contemplated hereby. The Parties further agree that the Parties shall not bring suit with respect to any disputes arising out of this Agreement or the transactions contemplated hereby in any court or jurisdiction other than the above specified court.

(c) To the extent that any Party has or hereafter may acquire any immunity from jurisdiction of any court or from any legal process (whether through service or notice, attachment prior to judgment, attachment in aid of execution, execution or otherwise) with respect to itself or its property, each such Party hereby irrevocably (i) waives such immunity in respect of its obligations with respect to this Agreement, and (ii) submits to the personal jurisdiction of any court described in Section 13.6(b).

(d) Each Party hereby irrevocably and unconditionally waives, to the fullest extent it may legally and effectively do so, any objection which it may now or hereafter have to the laying of venue of any suit, action or proceeding arising out of or relating to this Agreement or the transactions contemplated hereby in any court referred to in Section 13.6(b). Each of the Parties hereby irrevocably waives, to the fullest extent permitted by Applicable Law, the defense of an inconvenient
forum to the maintenance of such action or proceeding in any such court. **EACH PARTY HERETO WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY ACTION, SUIT OR PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT.**

13.7 **Waiver of Consumer Rights.** Participant hereby waives its rights under the Texas Deceptive Trade Practices - Consumer Protection Act, Section 17.41 *et seq.*, Business and Commerce Code, a law that gives consumers special rights and protections, and any similar law in any other state to the extent such Act or similar law would otherwise apply. After consultation with an attorney of Participant’s own selection, Participant voluntarily consents to this waiver. To evidence Participant’s ability to grant such waiver, Participant represents to Eureka that it (a) is in the business of seeking or acquiring, by purchase or lease, goods or services for commercial or business use, (b) has knowledge and experience in financial and business matters that enable it to evaluate the merits and risks of the transactions contemplated hereby, (c) is not in a significantly disparate bargaining position, and (d) has consulted with, and is represented by, an attorney of Participant’s own selection in connection with this transaction, and such attorney was not directly or indirectly identified, suggested, or selected by Eureka or an agent of Eureka.

13.8 **Parties Bear Own Expenses/No Special Damage.** Each Party shall bear and pay all expenses (including, without limitation, legal fees) incurred by it in connection with the execution of this Agreement. **NOTWITHSTANDING ANYTHING HEREIN TO THE CONTRARY, NO PARTY SHALL HAVE ANY OBLIGATIONS WITH RESPECT TO THIS AGREEMENT, OR OTHERWISE IN CONNECTION HEREWITH, FOR ANY INDIRECT, SPECIAL, CONSEQUENTIAL, EXEMPLARY OR PUNITIVE DAMAGES.** For purposes of the foregoing, actual damages may, however, include indirect, special, consequential, exemplary or punitive damages to the extent (i) the injuries or losses resulting in or giving rise to such damages are incurred or suffered by a Person which is not a Person indemnified pursuant to the Agreement.
(“Indemnified Person”) or an Affiliate of such Indemnified Person and (ii) such damages are recovered against an Indemnified Person by a Person which is not Indemnified Person or an Affiliate of such Indemnified Person. This Section shall operate only to limit a Party’s liability and shall not operate to increase or expand any contractual obligation of a Party hereunder or cause any contractual obligation of a Party hereunder to survive longer than provided in Section 8.3.

13.9 **Entire Agreement.** This Agreement, the Operating Agreements, the Third Party JOAs and the documents and instruments delivered on the date hereof in connection therewith contain the entire understanding of the Parties with respect to subject matter hereof and thereof and supersede all prior agreements, understandings, negotiations, and discussions among the Parties with respect to such subject matter.

13.10 **Inurement.** This Agreement shall be binding upon and shall inure to the benefit of the heirs, personal representatives, successors and assigns of the Parties and the terms and provisions hereof shall constitute covenants running with the lands subject hereto to the extent that such provisions apply to such lands.

13.11 **Notices.** All notices and other communications (including elections) required to be given under this Agreement shall (unless otherwise specifically provided herein) be in writing. Any such notice shall be deemed to be given and effective only upon receipt thereof by the Party who is to receive the notice. The receipt of a notice by facsimile (fax) shall be deemed to constitute delivery of such notice. If notice by fax is received other than during normal business hours, it shall be deemed received on the next business day. Notice sent by hand or overnight courier service shall be deemed to have been given one business day after sending. Notice sent by certified or registered mail, return receipt requested, shall be deemed received five (5) days after mailing. If notice is given by electronic communication (including e-mail and Internet or intranet websites), such notice shall be deemed received on the date of transmission or posting; provided that if such notice is not transmitted or posted during normal business hours, it shall be deemed received on the next business day. All notices required hereunder shall be given to the Parties at the following addresses:
If to Eureka: 1500 Turtle Creek Boulevard
Dallas, Texas 75201
Fax No.: 214.395.5631
Attn: David Jones
E-mail: djones@Eurekas.com

If to Participant: 451 Sandy Drive
Santa Fe, New Mexico 87501
Fax No.: 505.341.1234
Attn: John Hawk
E-mail: john_hawk@newmoney.com

or to such other place within the continental limits of the United States of America as a Party may designate for itself by giving notice to the other Parties, in the manner provided in this Section, at least ten (10) days prior to the effective date of such change of address.

13.12 Transfers Subject to This Agreement. Any sale, agreement, transfer or other disposition of an interest in the AMI, however accomplished, either voluntarily or involuntarily, by operation of law or otherwise, shall be subject to the terms of this Agreement. Any instruments which convey any interest in the AMI shall be made expressly subject to this Agreement.

13.13 References, Titles and Construction

(a) All references in this Agreement to articles, sections, subsections and other subdivisions refer to corresponding articles, sections, subsections and other subdivisions of this Agreement unless expressly provided otherwise.

(b) Titles appearing at the beginning of any of such subdivisions are for convenience only and shall not constitute part of such subdivisions and shall be disregarded in construing the language contained in such subdivisions.

(c) The words “this Agreement,” “this instrument,” “herein,” “hereof,” “hereby,” “hereunder” and words of similar
import refer to this Agreement as a whole and not to any particular subdivision unless expressly so limited.

(d) Words in the singular form shall be construed to include the plural and vice versa, unless the context otherwise requires. Pronouns in masculine, feminine and neuter genders shall be construed to include any other gender.

(e) Examples shall not be construed to limit, expressly or by implication, the matter they illustrate.

(f) The word “or” is not intended to be exclusive and the word “includes” and its derivatives means “includes, but is not limited to” and corresponding derivative expressions.

(g) All references herein to “$” or “dollars” shall refer to U.S. Dollars.

(h) The Exhibits listed in the List of Exhibits are attached hereto. Each such Exhibit is incorporated herein by reference for all purposes, and references to this Agreement shall also include such Exhibit unless the context in which used shall otherwise require.

13.14 **Further Assurances.** Each of the Parties agrees to perform such other acts and execute and deliver such other instruments as may be necessary in order to effectuate the terms of this Agreement.

13.15 **Relationship of the Parties.** The Parties do not intend to create a partnership or fiduciary relationship by entering into this Agreement. The Parties intend, however, that pursuant to the provisions of Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code, the arrangement created under this Agreement is to be treated as a partnership for U.S. federal and state income tax purposes, and each Party agrees not to elect to be excluded from the applicable provisions of said Subchapter K. Therefore, the Parties agree to be governed by the Tax Partnership Agreement attached
hereto as Exhibit “E”. The attached Tax Partnership Agreement, by this reference, is made a part hereof. The Tax Partnership Agreement shall govern all operations hereunder as a single tax partnership among the Parties notwithstanding that there will be multiple Operating Agreements and Third Party JOAs governing the Contract Areas designated therein. In the event of a conflict between the terms of an Operating Agreement or this Agreement and the terms and provisions of the Tax Partnership Agreement, the Tax Partnership Agreement shall prevail over the terms of both this Agreement and the Operating Agreement.

13.16 Force Majeure. Except for the obligations of each Party to make payments or to give notices as provided in this Agreement, no Party shall be liable for any failure to perform the terms of this Agreement when such failure is due to Force Majeure. The term “Force Majeure,” as used in this Agreement, shall mean acts of God, strike, lockout, or other industrial disturbance, act of the public enemy, wars, riots, blockades, public riot, lightning, fire, storm, flood or other act of nature, explosion, governmental actions or regulations, governmental delay, restraint or inaction, unavailability of equipment or water, inability to economically dispose of frac or drilling fluids 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 provide notice of the occurrence of a Force Majeure to the other Parties and 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.

13.17 Dispute Resolution.

(a) Any and all claims, disputes, controversies or other matters in question arising out of or relating to this Agreement or the transactions or matters contemplated hereunder (all of which are referred to herein as “Disputes”) shall be resolved solely in accordance with this Section 13.17, whether such Disputes sound in contract, tort, or otherwise, at law or in equity, under state or federal law, whether provided
by statute or the common law, for damages or any other relief.

(b) If a Dispute occurs that the senior representatives of the Parties responsible for the transaction contemplated by this Agreement have been unable, in good faith, to settle or agree upon within a period of five (5) Business Days after such Dispute arose, each of the Parties shall nominate and commit one of its senior officers to meet at a mutually agreed time and place not later than ten (10) Business Days after the Dispute has arisen to attempt to resolve same. If such senior representatives (or each Party’s senior officer, as applicable) have been unable to resolve such Dispute within a period of five (5) Business Days after such meeting, or if such meeting has not occurred within ten (10) Business Days following such Dispute arising, then any Party shall have the right, by notice to the others, to resolve the Dispute in accordance with Section 13.17(c).

(c) Any Dispute that is not resolved pursuant to the foregoing provisions of this Section 13.17 shall be settled exclusively and finally by arbitration in accordance with this Section 13.17(c).

(i) Such arbitration shall be conducted pursuant to the Federal Arbitration Act. The validity, construction, and interpretation of this Section 13.18(c), and all procedural aspects of the arbitration conducted pursuant hereto, including the determination of the issues that are subject to arbitration (i.e., arbitrability), the scope of the arbitrable issues, allegations of “fraud in the inducement” to enter into this Agreement or this arbitration provision, allegations of waiver, laches, delay or other defenses
to arbitrability, and the rules governing the conduct of the arbitration (including the time for filing an answer, the time for the filing of counterclaims, the times for amending the pleadings, the specificity of the pleadings, the extent and scope of discovery, the issuance of subpoenas, the times for the designation of experts, whether the arbitration is to be stayed pending resolution of related litigation involving Third Parties not bound by this Agreement, the receipt of evidence, and the like), shall be decided by the arbitrators. The arbitration shall be conducted using the Commercial Arbitration Rules of (but not administered by) the American Arbitration Association (the “AAA”) or any successor thereof when not in conflict with the Federal Arbitration Act.

(ii) All arbitration proceedings hereunder shall be before a panel of three (3) arbitrators. Each Person acting as an arbitrator must (1) be impartial, (2) not represent or work for or on behalf of any Party in any manner at the time of any proceedings described herein, and (3) have at least ten (10) years of experience in or relating to the oil and gas industry. Participant and Eureka shall each appoint one arbitrator and the third arbitrator shall be selected by the arbitrators appointed by Eureka and Participant within fifteen (15) days after their appointment. If either Participant or Eureka has failed to designate an arbitrator within fourteen (14) days after arbitration is requested, or if the two appointed arbitrators shall fail to select a third arbitrator within fifteen (15) days after their appointment, then an arbitrator shall be selected
by the Senior U.S. District Judge for the Northern District of Texas. Except as to the requirements set forth in the second sentence of this Section 13.17(c)(ii), no Party may dispute the appointment of any arbitrator selected by the other Party.

(iii) Discovery shall be made pursuant to the Rules of the AAA Procedure and completed within sixty (60) days of selection of the third arbitrator.

(iv) In deciding the substance of the Dispute, the arbitrators shall refer to the substantive laws of the State of Texas for guidance (excluding choice-of-law principles that might call for the application of the laws of another jurisdiction).

(v) The arbitrators shall conduct a hearing within ninety (90) days after appointment of the third arbitrator, and shall render a final decision completely disposing of the Dispute that is the subject of such proceedings within thirty (30) days after the final hearing. The Parties shall instruct the arbitrators to impose time limitations they consider reasonable for each phase of such proceeding, including, without limitation, limits on the time allotted to each Party for the presentation of its case and rebuttal. The arbitrators shall actively manage the proceedings as they deem best so as to make the proceedings fair, expeditious, economical and less burdensome than litigation. To provide for speed and efficiency, the arbitrators may: (i) limit the time allotted to each Party for presentation of its case; and (ii) exclude testimony and other evidence they deem irrelevant or cumulative.
(vi) The final decision of the arbitrators shall be in writing and set forth the reasons for such final decision, and if the arbitrators award monetary damages to any Party, contain a certification by the arbitrators that they have not included any incidental, special, treble, exemplary or punitive damages. To the fullest extent permitted by law and subject to the other provisions of this Agreement, the arbitration proceeding and the arbitrators’ decision and award shall be maintained in confidence by the Parties and the Parties shall instruct the arbitrators to likewise maintain such matters in confidence.

(d) Judgment on the award rendered pursuant to the terms of this Article XIII may be entered and enforced in any court having jurisdiction thereof in accordance with Applicable Laws. As between the Parties, only damages allowed pursuant to this Agreement may be awarded and, without limiting the foregoing, arbitrators shall have no authority to award any damages that are excluded under any express provision of the Agreement.

(e) The site of any arbitration brought pursuant to this Agreement shall be Houston, Texas, and the language in which the arbitration shall be conducted, including all writings relating thereto, shall be English.

(f) The Parties hereby agree to continue to perform their respective obligations under the Agreement while any Dispute is pending. Notwithstanding anything to the contrary herein, any Party may proceed to any court of competent jurisdiction to obtain provisional injunctive, ancillary or other equitable relief if such action is necessary to avoid irreparable harm or to preserve the status quo
pending the resolution of the Dispute in accordance with the provisions of this Article XIV. Notwithstanding the foregoing, the arbitration of the underlying Dispute shall proceed in accordance with the terms hereof during the pendency of the proceeding to obtain such provisional injunctive, ancillary or other equitable relief.

(g) EACH OF THE PARTIES HEREBY IRREVOCABLY AND UNCONDITIONALLY CONSENTS TO THE SUBMISSION OF ANY DISPUTE FOR SETTLEMENT BY FINAL AND BINDING ARBITRATION IN ACCORDANCE WITH THE PROVISIONS OF THIS ARTICLE XIV, AND HEREBY WAIVES THE RIGHT TO PROCEED TO COURT OR ANY OTHER FORUM THAT MAY APPLY TO IT BY REASON OF ITS PRESENT OR FUTURE DOMICILE, OR FOR ANY OTHER REASON EXCEPT (1) RECOURSE TO COURTS FOR ENFORCEMENT OF ARBITRAL AWARDS OR OTHER ORDER OF THE ARBITRATORS ISSUED IN AN ARBITRATION PURSUANT TO THIS ARTICLE XIV, (2) SEEKING ANY INTERIM OR CONSERVATORY MEASURES OF THE RULES OF ARBITRATION OF THE AAA, OR (3) SEEKING RELIEF AS DESCRIBED IN ARTICLE XIV HEREIN. NOTHING HEREIN SHALL AFFECT THE RIGHT OF ANY PARTY TO BRING ANY SUIT, ACTION OR PROCEEDING SEEKING TO ENFORCE ANY ARBITRAL AWARD OR OTHER ORDER OF THE ARBITRATORS ISSUED IN AN ARBITRATION PURSUANT TO THIS ARTICLE XIV OR SEEKING ANY INTERIM OR CONSERVATORY MEASURES PURSUANT TO THE RULES OF ARBITRATION OF THE AAA AGAINST ANY PARTY IN ANY OTHER JURISDICTION PERMITTED BY LAW.
13.18 **Confidentiality.** Except as otherwise provided herein, no Party shall divulge to any Third Party Geoscientific Data acquired, obtained or developed by the Parties hereto subsequent to the date of this Agreement involving the AMI, or any drilling information relative to any well or wells drilled as a result hereof, other than depth and information customarily publicized, without first obtaining the written consent of the other Parties to release any such information, which consent shall not be unreasonably withheld; provided, however, that such consent shall not be necessary for any Party to divulge such information to a Person from whom such Party may receive a contribution for the drilling of a well, or to any Third Party contracted as a consultant solely for the purpose of data analysis and evaluation, but only if such Person to whom the information is to be disclosed agrees to be subject to this provision prior to disclosure. All such information and data shall be treated as strictly confidential. Nothing contained herein shall be deemed to prevent disclosure of any such information or data if such disclosure is required by applicable laws or rules and regulations of any administrative or governmental agency or entity or by any standards or rules of any stock exchange to which any Party or any of its Affiliates is subject.

13.19 **Press Releases.** Unless consultation is prohibited by law, Participant and Eureka shall consult with each other before issuing any press release or otherwise making any public statement with respect to this Agreement or the transactions contemplated hereby and shall not issue any such press release or make any such public statement prior to such consultation (but no approval thereof shall be required).

13.20 **Counterpart Execution.** For execution, this Agreement may be executed in counterparts, all of which are identical and all of which constitute one and the same instrument. It shall not be necessary for Participant and Eureka to sign the same counterpart. This instrument may be validly executed and delivered by facsimile or other electronic transmission.

13.21 **Bankruptcy or Insolvency.** If any Party becomes insolvent or files for relief under the United States Bankruptcy Code, and all or any part of this Agreement is held to be an executory contract, then the other Party shall be entitled to a determination by the debtor in possession or any trustee as to the rejection or assumption of this Agreement within thirty (30) days from the date an order for relief is entered to seek adequate assurances
as to the future performance of the debtor’s obligations hereunder, and the protection of all interests affected thereby. To the extent permitted by order of the Bankruptcy Court the debtor Party shall satisfy its obligation to provide adequate assurances by advancing payments or depositing funds or appropriate legal instruments pursuant to a mutually acceptable escrow agreement.

13.22 Exclusive Remedy. The sole and exclusive remedy of the Parties hereto for any and all (i) claims relating to any representations, warranties, covenants and agreements contained in this Agreement, (ii) other claims pursuant to or in connection with this Agreement, and (iii) other claims relating to the Properties shall be any right to indemnification from such claims that is expressly provided in this Agreement, and if no such right of indemnification is expressly provided, then such claims are hereby waived to the fullest extent permitted by law.
IN WITNESS WHEREOF, the Parties have executed this Agreement in multiple counterparts as of the date first above written.

EUREKA OIL COMPANY

By: ________________________________
Name: Jeremy Villarreal
Title: President

NEW MONEY OIL CORPORATION

By: ________________________________
Name: Jessica Villarreal
Title: President
EXHIBIT “A-1”
Map of Primary Acreage AMI

EXHIBIT “A-2”
Map of Secondary Acreage AMI

EXHIBIT “A-3”
Leases

EXHIBIT “A-4”
Contracts

EXHIBIT “B”
Form of Operating Agreement

EXHIBIT “C”
Form of Conveyance

EXHIBIT “D”
Form of Gas Gathering Agreement

EXHIBIT “E”
Tax Partnership Agreement
EXHIBIT “F”

Representations and Warranties

ARTICLE 1

Representations of Eureka

Eureka represents to Participant that as of the date hereof:

1.1 Organization

Eureka is a corporation, duly organized, validly existing and in good standing under the laws of the State of Delaware and has all requisite power and authority to carry on its business as now being conducted. Eureka is duly qualified or licensed to do business and in good standing in each jurisdiction in which the nature of its business or the ownership or leasing of its properties makes such qualification or licensing necessary. No Proceedings to dissolve Eureka are pending or, to Eureka’s knowledge, threatened.

1.2 Power and Authority

Eureka has all requisite power and authority to execute, deliver, and perform this Agreement and each other agreement, instrument, or document executed or to be executed by Eureka in connection with the transactions contemplated hereby to which it is a party and to consummate the transactions contemplated hereby and thereby. The execution, delivery, and performance by Eureka of this Agreement and each other agreement, instrument, or document executed or to be executed by Eureka in connection with the transactions contemplated hereby to which it is a party, and the consummation by it of the transactions contemplated hereby and thereby, have been duly authorized by all necessary action of Eureka.

1.3 Valid and Binding Agreement

This Agreement has been duly executed and delivered by Eureka and constitutes, and each other agreement, instrument, or document executed or to be executed by Eureka in connection with the transactions contemplated hereby to which it is a party has been, or when executed will be, duly executed and delivered by Eureka, and constitutes, or when executed and delivered will constitute, a valid and legally binding obligation of Eureka, enforceable against it in accordance with their respective terms, except as such enforceability may be limited by bankruptcy, insolvency, moratorium or other similar laws affecting or relating to the enforcement of creditors’
rights generally and the application of general principles of equity (regardless of whether that enforceability is considered in a proceeding at law or in equity).

1.4 Non-Contravention

Except (i) for any consent to assignment requirements and any preferential purchase rights referenced in the Disclosure Schedule, and (ii) approvals required to be obtained from Governmental Entities who are lessors under leases forming a part of Participant’s Share of the Properties or who administer such leases on behalf of such lessors) which are customarily obtained post-closing (“Routine Governmental Approvals”), neither the execution, delivery and performance by Eureka of this Agreement and each other agreement, instrument, or document executed or to be executed by Eureka in connection with the transactions contemplated hereby to which Eureka is a party nor the consummation by Eureka of the transactions contemplated hereby and thereby do and will:

(a) conflict with or result in a violation of any provision of Eureka’s organizational documents;

(b) conflict with or result in a violation of any provision of, or constitute (with or without the giving of notice or the passage of time or both) a default under, or give rise (with or without the giving of notice or the passage of time or both) to any right of termination, cancellation, or acceleration under, any bond, debenture, note, mortgage or indenture, or any contract, agreement, or other instrument or obligation to which Eureka is a party or by which Eureka or the Properties may be bound;

(c) result in the creation or imposition of any Lien on any of the Properties; or

(d) result in a violation of any Applicable Law or any writ, injunction or decree binding upon Eureka or the Properties.

1.5 Pending Proceedings

Except as set forth in the Disclosure Schedule, there are no Proceedings pending or, to Eureka’s knowledge, threatened in writing, affecting, Eureka, or any of the Properties (including any actions challenging or pertaining to Eureka’s title to any of the Properties). There are no
Proceedings pending or, to the Eureka’s knowledge, threatened, in which Eureka is or may be a party affecting the acts of execution and delivery of this Agreement by Eureka or the consummation of the transactions contemplated hereby by Eureka.

1.6 **Compliance with Laws**

(a) Except for notices with respect to issues that have been finally resolved, the ownership and operation of the Participant’s Share of the Properties have been in compliance with all Applicable Laws. Except for notices with respect to issues that have been finally resolved, Eureka has not received any written notice from any Governmental Entity or any other Person that the Properties or Eureka, with respect to the Properties, is in violation of, or has violated, any Applicable Laws.

(b) Eureka has in effect all federal, state and local governmental permits reasonably necessary for it to own, lease or operate the Participant’s Share of the Properties and to carry on its business as now conducted, and there has occurred no default under any such permit.

1.7 **Brokers**

No broker, investment banker, financial advisor or other Person is entitled to any broker’s, finder’s, financial advisor’s or other similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Eureka for which Participant would be directly or indirectly liable.

1.8 **Regulation**

Eureka is not now an “investment company” or a company “controlled by” an “investment company” within the meaning of the Investment Company Act of 1940, as amended.

1.9 **Preferential Rights; Consents to Assign; Areas of Mutual Interest**

To Eureka’s knowledge, the Disclosure Schedule sets forth a complete and accurate list of the Properties and related agreements (i) that have any active areas of mutual interest to which Eureka is bound, and (ii)
that require any required consent or waiver of a preferential right from third parties in order for Eureka to consummate the transactions contemplated by this Agreement.

1.10 **AFE’s**

Except for drilling and normal ongoing lease operating expenses relating to the Wells or as set forth on the Disclosure Schedule, there is no individual outstanding call or payment under an authority for expenditures relating to any of the Properties which exceeds One Hundred Thousand Dollars ($100,000) (net to Participant’s Share of the Properties).

1.11 **Capital Commitments**

Except for Eureka’s obligations under the contracts set forth in “Exhibit A-4”, to Eureka’s knowledge, Eureka does not have any obligation for capital commitments or to carry or bear any other interest owner’s share of expenses or any similar obligations.

**ARTICLE 2**

Representations and Warranties of Participant

Participant represents to Eureka as of the date hereof:

2.1 **Organization**

Participant is a corporation validly existing and in good standing under the laws of the State of New Mexico and has all requisite power and authority to carry on its business as now being conducted. Participant is duly qualified or licensed to do business and in good standing in each jurisdiction in which the nature of its business or the ownership or leasing of its properties makes such qualification or licensing necessary, except in such jurisdictions where the failure to be so duly qualified or licensed and in good standing would not prevent or materially delay the consummation of the transactions contemplated by this Agreement.

2.2 **Power and Authority**

Participant has all requisite power and authority to execute, deliver, and perform this Agreement and each other agreement, instrument, or document executed or to be executed by Participant in connection with the transactions contemplated hereby to which it is a party and to consummate the transactions contemplated hereby and thereby. The execution, delivery,
and performance by Participant of this Agreement and each other agreement, instrument, or document executed or to be executed by Participant in connection with the transactions contemplated hereby to which it is a party, and the consummation by it of the transactions contemplated hereby and thereby, have been duly authorized by all necessary action of Participant.

2.3 Valid and Binding Agreement

This Agreement has been duly executed and delivered by Participant and constitutes, and each other agreement, instrument, or document executed or to be executed by Participant in connection with the transactions contemplated hereby to which it is a party has been, or when executed will be, duly executed and delivered by Participant, and constitutes, or when executed and delivered will constitute, a valid and legally binding obligation of Participant, enforceable against it in accordance with their respective terms, except as such enforceability may be limited by bankruptcy, insolvency, moratorium or other similar laws affecting or relating to the enforcement of creditors’ rights generally and the application of general principles of equity (regardless of whether that enforceability is considered in a proceeding at law or in equity).

2.4 Non-Contravention

Except for (i) requirements (if any) that there be obtained consents to assignment (or waivers of preferential rights to purchase) from third parties, and (ii) Routine Governmental Approvals, neither the execution, delivery, and performance by Participant of this Agreement and each other agreement, instrument, or document executed or to be executed by Participant in connection with the transactions contemplated hereby to which it is a party nor the consummation by it of the transactions contemplated hereby and thereby do and will:

(a) conflict with or result in a violation of any provision of Participant’s organizational documents;

(b) conflict with or result in a material violation of any provision of, or constitute (with or without the giving of notice or the passage of time or both) a material default under, or give rise (with or without the giving of notice or the passage of time or both) to any right of termination, cancellation, or acceleration under, any bond, debenture, note, mortgage or indenture, or any contract, agreement, or other instrument
or obligation to which Participant is a party or by which Participant or any of Participant’s properties may be bound; or

(c) result in a material violation of any Applicable Law or any writ, injunction or decree binding upon Participant.

2.5 Pending Proceedings

There are no Proceedings pending or, to Participant’s Knowledge, threatened, in which Participant is or may be a party affecting the execution and delivery of this Agreement by Participant or the consummation of the transactions contemplated hereby by Participant.

2.6 Investment Experience

Participant acknowledges that it can bear the economic risk of its investment in the Property, and has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of an investment in the Properties.

2.7 Restricted Securities

Participant is an “accredited investor,” as such term is defined in Regulation D of the Securities Act of 1933, as amended, and at Closing will acquire Participant’s Share of the Properties for its own account and not with a view to a sale or distribution thereof in violation of the Securities Act of 1933, as amended, and the rules and regulations thereunder, any applicable state blue sky laws or any other applicable securities laws.

2.8 Independent Evaluation

Participant is an experienced and knowledgeable investor in the oil and gas business and the business of owning and operating oil, gas and mineral properties. Participant has had access to the Properties, the officers, consultants and other representatives of Eureka, and the books, records, and files of Eureka relating to Participant’s Share of the Properties. In making the decision to enter into this Agreement and to consummate the transactions contemplated hereby, Participant has relied on (i) the basis of its own independent due diligence investigation of Participant’s Share of the Properties, and (ii) EUREKA’S EXPRESS WARRANTIES, and has been advised by and has relied solely on its own expertise and legal, land, tax, reservoir engineering, and other professional counsel concerning this transaction, Participant’s Share of the Properties, and the value thereof.
2.9 **Brokers**

No broker, investment banker, financial advisor or other Person is entitled to any broker’s, finder’s, financial advisor’s or other similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Participant which Eureka may be obligated to pay.

**EXHIBIT “G”**

*Development Plan*

**EXHIBIT “H”**

*Existing Burdens*

**EXHIBIT “I”**

*Form of Assignment*