

HOW TO MAKE DEDUCTIONS FROM THE ROYALTY STREAM FOR POST-PRODUCTION EXPENSES

Minimizing Liability While Improving the Company's Bottom Line

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OBJECTIVE

- Attendees will have both the knowledge and the “map” needed to implement a program of royalty deductions for an employer or a client. Big money beckons.
- Attendees will be able to avoid the pitfalls of a poorly-executed deductions program.



INTRODUCTION

OVERVIEW

Most private Oil & Gas Leases have language that requires royalty owners to pay their proportionate share of taxes, regulatory fees and the expenses to treat:

crude oil,
natural gas and
gas liquids

as well as expenses to market those products.

Some leases require royalty owners to pay their share of electricity bills, if the Lessee is required to use electric motors rather than internal combustion engines for power.

Most appellate courts have said those requirements are valid.

THE WILD WEST

Your professional organization works to remedy lack of uniformity in contracts such as the Model Form Operating Agreement.

Royalty deductions are fairly big news. They can save small producers bacon in bad times. They can boost economics in any times. They can preserve skinny leases. So lots of folks are doing them. **And every company does them differently.**

This seminar is presented with the intention of helping make royalty deductions more uniform.



DEDUCTIONS

Operators may hold back part of the gross royalty to reimburse themselves for the royalty owner's share of such costs.

Many companies deduct far less than they are entitled to deduct because setting up a system to do that appears to be too complex.

This system reduces that complexity to manageable size.

“EVERYBODY DEDUCTS FOR DEHY.”

“CAN YOU DEDUCT FOR METERS?”

“WHAT DOES ‘POST-PRODUCTION’ MEAN, EXACTLY?”

“WHAT DO THE COURTS SAY?”

“WILL WE GET SUED IF WE DEDUCT?”

“HOW DO YOU MAKE SURE IT'S FAIR?”



BENEFIT?

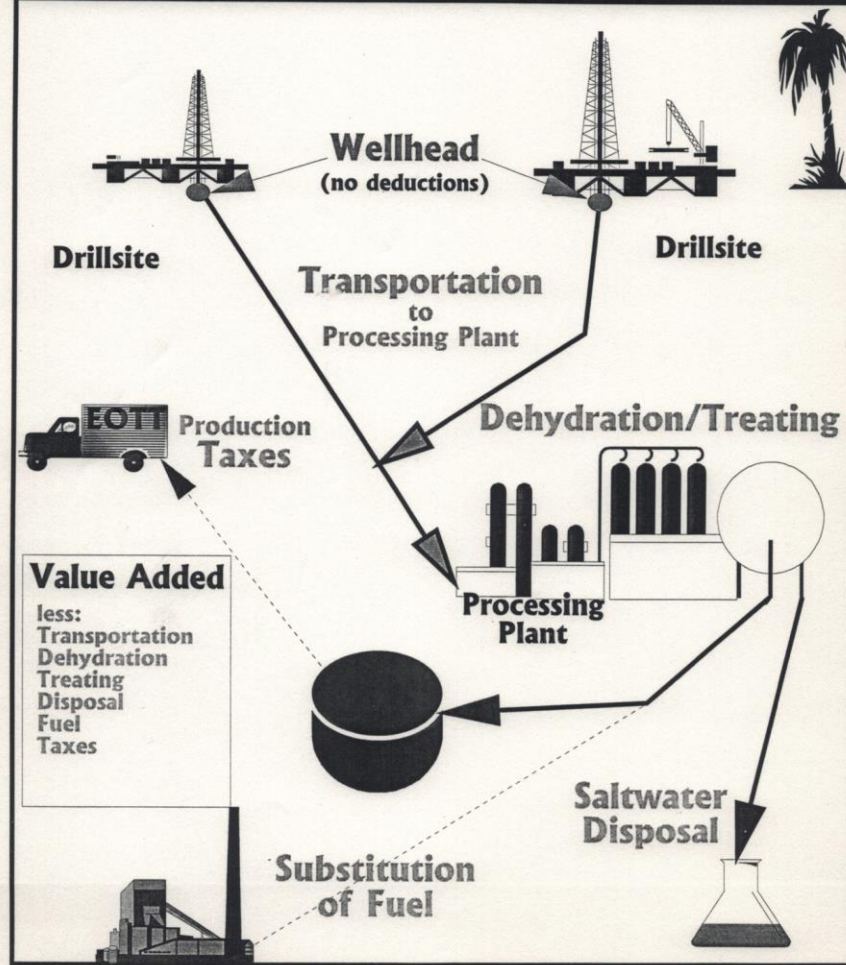
A producer might reduce his actual royalty outgo by as much as 25%. So a 1/6th royalty interest (16.667%) might effectively have a 12.5% actual payment. So if the producer's gross revenue is \$1,000,000.00 monthly, and the savings are 4.167%, then the producer keeps \$41,670.00 which would otherwise be OVERPAID to the royalty owners. That may pay for 3 or 4 recompletions per year. Added production from those recompletions results in added income for the royalty owners, as well as extending the economic life of the lease.

METAPHOR

A tax attorney or CPA might find deductions to use in our income tax returns that we do not know about. Are we entitled to take those extra deductions? YES, if the regulations allow.



ROYALTY DEDUCTIONS



BACKGROUND

“THE GREAT DIVIDE” PRE- OR POST-PRODUCTION?

LEGAL RULINGS Appellate Courts in most States have usually said the divide between activities for which the Lessee is solely responsible, and activities for which the Lessor and Lessee are jointly responsible, is the WELLHEAD; absent specific language to the contrary.

Why? Because that is the point at which almost all leases and most adjudication say that the Lessor comes into ownership of their share (royalty %) of production.



WELLHEAD

EXPLORATION	PRODUCTION	(	TREATING	MARKETING
)		
Geophysics	Infill Drilling	(
Geology	Completion)		
Leasing	Pumping Unit, Engine	(
Drill Wildcat	Initial Tankage)		
Test Wildcat	Initial Pumps	(
	Initial Flowlines)		
	Initial Meters	(
	Free Water Drain)		
		(	Heating Crude	Find Right Buyer
		)	Gas Refrigeration	Loading Rack
		(	Chemicals	Sales Contract
		)	Emulsion Break	Meter Fees
		(	Bad Gas Removal	Trucking
		)	Wastewater Remov.	Check Run Tickets
		(	Wastewater Treat.	Gas Sales
		)	Wastewater Disp.	Gas Liquids Sales
		(	Repair Facilities	Gas Compression
		)	Maintain Pipelines	(most States)
		(	Sludge Disposal	
		)	Blending liquids	
		(	Permitting for the Activities Listed Above	
)		
		(	NOTE: PART OF OVERHEAD IS ALLOCABLE TO THE ITEMS LISTED ABOVE.	
)		



THREE LEGGED STOOL

Royalty deductions are based on:

- Lease language,
- Adjudication, and
- Conditions in the field for each property.



INPUTS FOR SETTING UP A DEDUCTIONS PROGRAM

FEASIBILITY

LEGAL

Adjudication (or statute) in States where your company operates, with brief summaries of outcomes.

ACCOUNTING

- Recent 1-month expense and revenue for leases being tested.
 - Accounting being done by LEASE or by WELL or by UNIT?
-

LAND

- Lease review and charting.
 - Spreadsheet.
-

IMPLEMENTATION

ACCOUNTING

Sends monthly expenses and revenue (by lease, by well or by unit) to Land.

LAND

- Prepares spreadsheet for each node.



IS IT FEASIBLE FOR YOUR COMPANY OR CLIENT?

LEASE LANGUAGE

Spot-check the royalty clause in a few leases in a few big properties for “at the wellhead” language. Federal, Indian and most State Lands leases FORBID deductions.

Check with your attorney regarding the adjudication in the State or States where your company’s or client’s properties are located to determine general guidelines for deducting.

KEY POINT:

DOES THE LEASE SAY LESSOR GETS HIS ROYALTY SHARE AT THE WELLHEAD? If “yes”, then YOU **MAY DEDUCT** for that lease, **UNLESS** forbidden by lease language. (See below)



KEY POINT:

DOES THE LEASE SAY ROYALTIES ARE BASED ON “NET PROCEEDS”, OR DOES IT SPECIFICALLY EXCLUDE DEDUCTIONS? If “yes” to either, then YOU **MAY NOT DEDUCT** for that lease.

Appellate-level courts in different States have ruled differently on the meaning of this term, which almost all Oil & Gas Leases contain (see appendix).

Most courts take this at its face value. A few have said that royalty oil and gas are valued at the market. Those courts rely on a concept (which they read into the lease) called “the implied covenant to market” or the “first marketable product” valuation.

GENERAL FACTORS

Costs netted out of the purchaser’s checks (transportation, B, S & W) have already been shared proportionately between Lessor and Lessee and can be ignored.

Most States do NOT have a statute which governs deductions. (See below).

The general lineup for States is shown below, but **CHECK WITH YOUR ATTORNEY** to verify that your company’s or client’s production is located in an “at the wellhead” State.



ROYALTY VALUED AT THE WELLHEAD

CALIFORNIA

Alamitos Land Co. v. Shell Oil Co. 3 Cal. 2nd 396, 402-403 (Cal. 1935).

Western Gulf Oil Co. v. Title Insurance and Trust Co., 92 Cal. App 2d 25 (Cal Dist Ct. App. 1949).

Vedder Petroleum Corporation, Limited, v. Lambert Lands Co., 122 P.2d 600 (Cal Ct. App. 1942).

Vedder Petroleum Corporation, Limited, v. Lambert Lands Co., 159 P 2d 435 (1946).

LOUISIANA

Wall v. United Gas Public Service, 152 So. 561 (La 1943).

E. W. Merritt v. Southwestern Electric Power Co., 449 So. 2d 210, 213 (La. App. 2d Cir. 1986).

Crichton et al. v. Standard Oil Co 150 So 668; 1933, La.



ROYALTY VALUED AT THE WELLHEAD

- ARKANSAS Clear Greek Oil & Gas Company v. Bushmaier_165 Ark. 303; 264 S. W. 830; 1924 Ark.

Parnell, Inc. v. Giller_372 S.W.2d 627; 1963 Ark.



ROYALTY VALUED AT THE WELLHEAD

- KANSAS Martha Sternberger. v. Marathon Oil Company. 894 P.2d 788; 1995 Kan.

R.B. Molter v. John Lewis. 134 P.2d 404; 1943 Kan.



ROYALTY VALUED AT THE WELLHEAD

- KANSAS D.L. Voshell v. Indian Territory
• Illuminating Oil Company. 19 P.2d 456;
• 1933 Kan.

- KENTUCKY C.M. Reed v. Hackworth. 287 S.W.2d
912; 1956 Ky.

Poplar Creek Development Company
v. Chesapeake Appalachia 2009 US
6th Cir. (KY 2009).



ROYALTY VALUED AT THE WELLHEAD

- LOUISIANA 561 (La 1943).
Wall v. United Gas Public Service, 152 So.
E. W. Merritt v. Southwestern Electric
Power Co., 449 So. 2d 210, 213 (La.
App. 2d Cir. 1986).
Crichton et al. v. Standard Oil Co 150
So 668; 1933, La.



ROYALTY VALUED AT THE WELLHEAD

- MICHIGAN** Schroeder, v Terra Energy_565 -
N.W.2d 88; Mich. App.
- OHIO** Lutz v, Chesapeake Appalachia
N.D. Ohio No. 4:09-cv-2256 (Oct,
2017).
- ARKANSAS** Clear Creek Oil & Gas v Bushmaier
165 Ark. 303; 264 S. W. 830; 1924
Ark.



MISSISSIPPI

Pursue Energy v. Abernathy 2009-CA-01794-SCT. (October, 2011).

MONTANA

No definitive adjudication but Montana Power v. Kravik 586 P.2d 298, 302 (1978) implies that royalties should be paid at the well.

NEW MEXICO

Carson v. Amoco, 10 P.3d 853 and P.3d 843, NM App. (Sept. 2000).

NORTH DAKOTA

Bice v. Petro-Hunt, ND 124, 768 N.W.2d 496 (2009).

Dorothea C. West v. Alpar Resources, Inc., 298 N.W.2d 484; 1980 N.D.



ROYALTY VALUED AT THE WELLHEAD

- OKLAHOMA Mittelstaedt v. Santa Fe Minerals, Inc. P.2d
1203; 1998 Okla.
- Katschor et al. v. Eason Oil Co. et al 63 P.2d
P.2 977; 1936 Okla.
- TEXAS Carter v. Exxon Corporation 842
S.W.2d 393; 1992 Tex. App.
- Judice v. Mewbouren Oil Company, et al, al,
al, 939 S.W.2d 133; 1996 Tex.



ROYALTY VALUED AT THE WELLHEAD

- TEXAS Heritage Resources, Inc. v.
 NationsBank 939 S. W. 2nd 118 (Tex. 1995)
- West Virginia Leggett v. EQT Production Co. 10-
 0136, W. Va. Supreme, 2017



UTAH

No definitive adjudication but a coal case (Trail Mountain Coal v. Division of State Lands 884 P.2d 1265, 1270-1271 (Utah App. 1994) allowed deduction of transportation costs from royalty payments.

FEDERAL & INDIAN

Hurinenko v. Chevron, USA, Inc.; 69 F.3d 283; 1995 U.S. App.

Ramming v. Natural Gas Pipeline 390 F.3d 366; 2004 U.S. App.

The Piney Woods Country Life School. v. Shell Oil Company 726 F. 2nd 225; 1984 U.S. App.

Atlantic Richfield Company v The Farm Credit Bank of Wichita. 226 F.3d 1138; 200 U.S. App.

Old Kent Bank & Trust Company v. Amoco Production Company. 679 F. Supp 1435; U.S. Dist.



ROYALTY VALUED AT THE MARKET

FEDERAL
& INDIAN

Limited by statute (30 CFR, Part 206) to transportation and processing.

COLORADO

Garman v. Conoco, Inc. 866 P. 2nd 652 (Colo. 1994)
Rogers v. Westerman Farms 2001

WYOMING

Limited by statute (30-5-304) to transportation beyond the sales point.



KEY LEGAL POINT

Unless your attorney specifically says this is NOT the case for the State you are studying, if the lease is ***SILENT*** about deductions, then YOU MAY DEDUCT.

Most “Producers 88” lease forms are either silent or allow some deductions.

So the DEFAULT “setting” for deductions is **YES, YOU MAY**.



FOUNDATIONAL CONTRACT

**WHAT DOES THE
LEASE SAY?**



HOW DOES A DEDUCTIONS-FRIENDLY LEASE LOOK?

- ROYALTY CLAUSE Include:
 - Royalty payable at the wellhead,
 - Free lease fuel language,
 - Payment at posted price,
 - No royalty payable for operations on lease,
 - Gas royalty paid on net after deducting costs,
 - Gas liquids royalty paid on percentage of net.
- * Power for substitute fuel is deductible.



DEDUCTIONS-FRIENDLY LEASE CONTINUED

- OTHER DEDUCTIONS- Include
- Property tax (AKA School tax, ad valorem, mineral rights tax),
- Severance tax (if your company pays),
- Licenses, franchise fees, right-to-operate fees,
- Regulatory costs—filing reports,
- Environmental costs—emissions measure.



SIGNIFICANT LEASE LANGUAGE

OIL ROYALTY CLAUSE: “Lessee shall pay Lessor as royalty on the oil produced and saved hereunder the market price of $\frac{1}{6}$ th of $\frac{8}{8}$ ths of such production sold by Lessee. In calculating such royalty, Lessee may deduct Lessor’s proportionate share of a reasonable charge for dehydration and for treating such oil and a reasonable charge for transportation to the treating plant or sales point.”

EXPLICIT CONSENT FOR DEDUCTIONS. CALIFORNIA STANDARD OIL FORM.



SIGNIFICANT LEASE LANGUAGE

ALTERNATE OIL ROYALTY CLAUSE:

“The royalties to be paid by Lessee are: (a) on oil, and on other liquid hydrocarbons saved at the well, one-eighth of that produced and saved from said land, same to be delivered free of cost at the wells or to the credit of Lessor in the pipe line to which the wells may be connected ...”

N.D. Producers 88 Rev. 2-20-61

This lease is SILENT, so deductions MAY BE MADE.



SIGNIFICANT LEASE LANGUAGE

GAS ROYALTY CLAUSE

“Lessee shall pay Lessor as royalty on gas (including casinghead gas) produced and saved hereunder the market price of $\frac{1}{6}$ th of $\frac{8}{8}$ ths of such production sold by Lessee. In calculating such royalty, Lessee may deduct Lessor’s proportionate part of processing, treating, compressing, handling and transporting gas in connection with the sale thereof.”

Texas Producers 88

Explicit consent for deductions.



SIGNIFICANT LEASE LANGUAGE

ALTERNATE GAS ROYALTY CLAUSE

“... (b) on gas, including casinghead gas and all gaseous substances, produced from said land and sold or used off the premises or in the manufacture of gasoline or other products therefrom, the market value at the mouth of the well of one-eighth of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-eighth of the amount realized from such sale ...”

N. D. Producers 88 Rev. 2-20-61 Lease is silent, so deductions MAY BE MADE.



SIGNIFICANT LEASE LANGUAGE

GAS LIQUIDS ROYALTY CLAUSE

“In the event Lessee shall transport gas from demised premises to a plant for removal of gasoline from produced gas, then royalty share of one-eighth (12.5%) shall be payable for said gasoline at 60% of the actual market price received for said gasoline, or the price payable in the field for gasoline of similar composition, less the cost of transportation to said plant,”

Unocal California form. Lessee pays royalty on 60% of gas liquids income, AFTER deducting pipeline and meter costs.



SIGNIFICANT LEASE LANGUAGE

PROPERTY TAX CLAUSE

“If the assessed valuation of the demised premises (exclusive of Lessee’s improvements thereon) be hereafter increased because of the discovery of oil or gas thereon Lessee shall pay five-sixths (5/6ths) of all taxes levied upon the increase over the assessed valuation for the fiscal year preceding the date of discovery of such oil or gas, and Lessor shall pay the balance of the taxes and/or assessments on said land ...”

California Chevron form Property tax and severance tax are split between Lessor and Lessee (not equipment).



SIGNIFICANT LEASE LANGUAGE

OTHER TAXES CLAUSE

“If under present law or any laws which may hereafter be enacted this lease and/or the leasehold estate created hereby and/or the oil, gas mineral or mineral rights or mining rights or rights to operate wells in said premises are assessed separately and apart from said land under any name or designation whatsoever and/or if any tax, assessment, fee, license or certification requirement is levied or assessed which is based upon the quantity of production of oil or gas from said lands or the right to operate wells on said premises, whether assessed or ...



Other Taxes Clause Continued

... levied to or against Lessee or Lessor, then five-sixths (5/6ths) of the taxes so levied shall be paid by Lessee, and the remainder shall be paid by Lessor.”

California Chevron form. All costs caused by governmental or regulatory agencies are deductible.



SIGNIFICANT LEASE LANGUAGE

ALTERNATE POWER CLAUSE “In the event Lessee shall use electricity to power its equipment on demised premises, Lessor agrees it shall pay its royalty share of costs of electric power.”

California Unocal form. Royalty share of electric costs are deductible.



SIGNIFICANT LEASE LANGUAGE

B, S & W CLAUSE “Lessee may make customary adjustments for temperature, water and sediment ...”

California Mobil form.

The crude purchaser or gas purchaser normally adjusts for these, leaving a payment from which deductions are already charged to the Lessors.



APPROXIMATE RANGE OF VALUE PER ROYALTY BARREL FOR ABOVE CLAUSES

Example numbers for one lease producing 300 BOPD, 800 MCFGPD and 100 gallons of gas liquids per day.

OIL ROYALTY CLAUSE \$.50 to \$5.00, depending on water cut, oil gravity and undesirable constituents such as high sand content. So mid-range $\$2.75 \times 300 \text{ BOPD} \times 30 \text{ days} @ 16.667\% = \mathbf{\$4,125.83}$ per month to be shared proportionately by royalty owners for oil treating.



APPROXIMATE RANGE OF VALUE PER ROYALTY BARREL FOR ABOVE CLAUSES

Example numbers for one lease producing 300 BOPD, 800 MCFGPD and 100 gallons of gas liquids per day.

GAS ROYALTY CLAUSE \$.10 to \$1.25, depending on water cut, gas content and undesirable constituents such as hydrogen sulfide. So mid-range $\$.675 \times 800 \text{ MCFPD} \times 30 \text{ days} @ 16.667\% = \mathbf{\$2,700.54}$ per month to be shared proportionately by royalty owners for gas treating.



APPROXIMATE RANGE OF VALUE PER ROYALTY BARREL FOR ABOVE CLAUSES

Example numbers for one lease producing 300 BOPD, 800 MCFGPD and 100 gallons of gas liquids per day.

GAS LIQUIDS CLAUSE \$.05 to \$.50 per gallon, depending on who strips the liquids out of the wet gas and the quality of gas liquids. So mid-range $\$.25 \times 100 \text{ gallons} \times 30 \text{ days} @ 16.667\% = \mathbf{\$75.02}$ per month to be shared proportionately by royalty owners for gas liquids treating.



APPROXIMATE RANGE OF VALUE PER ROYALTY BARREL FOR ABOVE CLAUSES

PROPERTY TAX CLAUSE Also known as mineral rights tax, school tax or ad valorem tax, \$300 to \$1,200 per month, depending on State where production is located. So mid-range $\$750 \times 16.667\% = \mathbf{\$125.03}$ to be shared proportionately by royalty owners for this tax.



APPROXIMATE RANGE OF VALUE PER ROYALTY BARREL FOR ABOVE CLAUSES

SEVERANCE TAX CLAUSE Likely paid by crude and gas purchasers, so will already be deducted from both working interest owners and royalty owners.



APPROXIMATE RANGE OF VALUE PER ROYALTY BARREL FOR ABOVE CLAUSES

OTHER TAX CLAUSE These may include business license tax, franchise fee, transportation facility tax, State DOT fee, groundwater protection fee, air pollution assessment, discharge permit, vessel certification, valve inspection, fire inspection, OSHA inspection, idle well fluid level measurement, air quality fee, production reporting cost, emissions inspection.

\$300 to \$1,500 per month, depending on State. So mid-range \$900 X 16.667% = **\$150.03** to be shared proportionately by royalty owners for other taxes.



APPROXIMATE RANGE OF VALUE PER ROYALTY BARREL FOR ABOVE CLAUSES

ALTERNATE POWER CLAUSE If electricity is used as prime power source, AND if the lease includes a free fuel provision. \$12,000 to \$40,000 depending on local cost of electricity. So mid-range $\$26,000 \times 16.67\% =$ **\$4,334.20** to be shared proportionately by royalty owners for alternate power.



APPROXIMATE RANGE OF VALUE PER ROYALTY BARREL FOR ABOVE CLAUSES

BS & W CLAUSE Likely to be deducted by crude and gas purchasers, so will already be deducted from both working interest owners and royalty owners.

ROYALTY BARREL = ROYALTY SHARE OF CRUDE OIL
So 300 BOPD with a 1/6th lease has 50 royalty barrels.



APPROXIMATE RANGE OF VALUE PER ROYALTY BARREL FOR ABOVE CLAUSES

TOTAL So assuming only the MEDIAN costs in the field, but assuming the most favorable lease language, the savings for this ONE LEASE for ONE MONTH would be:

- Oil \$4,125.83
- Gas \$2,700.54
- Gas Liquids \$ 75.02
- Property Tax \$ 125.03
- Other Taxes & Fees \$ 150.03
- Alternate Power \$4,334.20
- TOTAL \$11,510.65



APPROXIMATE RANGE OF VALUE PER ROYALTY BARREL FOR ABOVE CLAUSES

MULTIPLE LEASES

If your company or client has 10 such leases,
the savings could be over \$100,000 PER MONTH, EVERY MONTH.



LANGUAGE WHICH PROHIBITS DEDUCTIONS

ABSOLUTE BAN The following language, or similar wording, forbids any deductions at all. The lease language always controls.

“The royalties provided in this paragraph shall be determined and delivered to Lessor free of any exploration, development, production, compression, processing, treating, transportation, wastewater handling, marketing, delivery or like costs to the point of delivery for sale ... ”

(OFTEN A CUSTOM LEASE)



LANGUAGE WHICH PROHIBITS DEDUCTIONS

HOWEVER ... Language such as the following does **NOT** by itself ban deductions.

“Said royalty shall be delivered free of cost to Lessor into the tanks on leased premises.”

This language does not cover post-production costs, taxes, regulatory fees, or other taxes. It covers expenses **BEFORE** the wellhead.



AUTHORIZATION

AUTHORIZATION

If you believe a deductions program is feasible for your company, ask for authorization.

You will need to ask for:

- dedicated time from your own regular schedule, and
- time from an accounting person and an attorney.



BUILD THE PROJECT

SAMPLE CHART OF ACCOUNTS (a list of expense items, normally coded by field personnel into a booked monthly)

<u>LINE ITEM</u>	<u>GENERAL DEDUCTIBILITY</u> (Subject to Lease Terms, Actual Field Conditions and Adjudication)
Accounting	Partly
Bonding	Not
Chemical	Deductible
Communications	Partly
Dehydration of Oil	Deductible for water remaining after free water drainoff
Easements	Partly
Electricity	Partly or Fully Deductible (See discussion below)
Emissions Controls or Prevention	Deductible
Engineering	Not
Environmental Compliance	Deductible
Environmental Fees	Deductible
Flare	Deductible
Franchises for Pipelines	Deductible
Fuel Gas	Deductible
Gas Liquids Separation	Deductible



Gas Treating	Deductible
Geological & Geophysical	Not
Heater Treater	Deductible
Insurance	Partly
LACT	Deductible
Legal	Not
Marketing	Deductible
Metering	Deductible
Office	Partly
Pipeline	Deductible
Production Equipment	Not
Rent	Partly
Regulatory Compliance	Deductible
Regulatory Fines	Not
Rods and Tubulars	Not
Royalty Payment (accounting)	Partly
Salaries (Company)	Partly
Salaries (Contract)	Partly
Tank Bottom Disposal	Deductible



Taxes (Income)	Not
Taxes (Mineral)	Deductible
Taxes (Excise)	Deductible
Taxes (Severance)	Deductible
Treating Equipment	Deductible
Trucking (General)	Partly
Trucking (Oil Sales)	Deductible
Vacuum Truck	Deductible
Vehicles	Partly
Wastewater Cleaning or Treatment	Deductible
Wastewater Disposal	Deductible
Water Injection	Not
Water Purchase	Not
Well Drilling	Not
Well Plugging and Abandonment	Not
Well Pulling & Workover	Not



GET THE REAL DEAL

Ask Accounting for a printout showing your company's or your client's list of expense items.



DETERMINE ALLOCATIONS

INTERVIEW

For each field, ask the company's or client's Field Superintendent about the "PARTLY" items in the Chart of Accounts that occur IN THE FIELD.

YARDSTICK #1

Note the items that are wholly deductible, such as chemical, environmental/regulatory, severance tax, wastewater disposal and property tax.

YARDSTICK #2

What percentage of stuff that happens IN THE FIELD is attributable to post-production activities? A normal range is 15 to 35%, with gas properties falling toward the bottom of the range and oil properties coming in higher. 30% for oil is usually defensible.

YARDSTICK #3

Use the same percentage for office activities.



Add allocations to your Chart of Accounts.

			<u>%</u>
Accounting	Partly	(Office)	30
Chemical	Deductible		100
Communications	Partly	(Office)	30
Dehydration of Oil	Deductible for water remaining after free water drainoff		
Easements	Partly	(Field)	30
Electricity	Partly or Fully Deductible (See discussion below)		
Emissions Controls or Prevention	Deductible		100
Engineering	Not		
Environmental Compliance	Deductible		100
Environmental Fees	Deductible		100
Flare	Deductible		100
Franchises for Pipelines	Deductible		100
Fuel Gas	Deductible		100
Gas Liquids Separation	Deductible		100
Gas Treating	Deductible		100
Geological & Geophysical	Not		
Heater Treater	Deductible		100
Insurance	Partly	(Office)	30
LACT	Deductible		100
Legal	Not		
Marketing	Deductible		100
Metering	Deductible		100
Office	Partly	(Office)	30
Pipeline	Deductible		100
Production Equipment	Not		



			<u>%</u>
Rent	Partly	(Field)	30
Regulatory Compliance	Deductible		100
Regulatory Fines	Not		
Rods and Tubulars	Not		
Royalty Payment (accounting)	Not		
Salaries (Company)	Partly	(Field)	30
Salaries (Contract)	Partly	(Field)	30
Tank Bottom Disposal	Deductible		100
Taxes (Income)	Not		
Taxes (Mineral)	Deductible		100
Taxes (Excise)	Deductible		100
Taxes (Severance)	Deductible		100
Treating Equipment	Deductible	[Capital, 1.67%] Repair Field	100
Trucking (General)	Partly	(Field)	30
Trucking (Oil Sales)	Deductible	[If not netted from revenue]	100
Vacuum Truck	Deductible		100
Vehicles	Partly	(Field)	30
Wastewater Cleaning or Treatment	Deductible		100
Wastewater Disposal	Deductible		100
Water Injection	Not		
Water Purchase	Not		
Well Drilling	Not		
Well Plugging and Abandonment	Not		
Well Pulling & Workover	Not		



SPREADABLE EXPENSES

POSSIBLE PRELIMINARY SPREADSHEET

Some accounting systems break expenses into 2 broad categories.

Those are:

- * direct expenses for a single property (unit, lease or well), and
- * a group of properties which share some categories of expenses.

DO YOU HAVE SHARED EXPENSES?

Ask your accounting contact if some expense line items apply to **SHARED EXPENSES** (for example) a group of non-unitized leases, each with its own pumper, that share expenses for items like:

- * field superintendent,
- * vehicles, and
- * field office.

If so, build a spreadsheet with those SPREADABLE expenses.

Allocations to use are the amount per lease of barrels (or MCF's) sold, divided by the total for the leases.



LINE ITEM:	AMOUNT	-LEASE 1 ALLOC	-LEASE 2 ALLOC	-LEASE 3 ALLOC
	\$	\$ (20%)	\$ (30%)	\$ (50%)
Superinten	1,000	200	300	500
Vehicles	200	40	60	100
Field Office	500	100	150	250

DOUBLE ENTRIES

Some expenses may show as both Spreadable and Direct. For example, Accounting may show a wastewater disposal expense at the Lease level for actual cost of transporting barrels, PLUS a wastewater disposal expense at the SPREADABLE level for the cost of maintaining a central facility serving multiple leases. In such case, list both, with a notation:

- Wastwtr Disp (Lse)
- Wastwtr Disp (Facil)



LEASE REVIEW

LOOK FOR

Check the language in your leases. Build a chart with 3 categories of lease language.

LEASE #	ALLOWS ALL DEDS	ALLOWS NO DEDS	ALLOWS SOME DEDS
TX 891	Y		
TX 893		Y	
TX 898			Y, dehy only

STEPS

Follow these steps for leases in States that value at the wellhead:

- 1: Is royalty valued at the wellhead or is the lease silent as to deductions? If yes, the “Yes” goes in the first column—Allows all Deductions.
- 2: Are taxes and regulatory costs deductible or is the lease silent as to deducting taxes and regulatory costs? If yes, the “Yes” goes in the first column—Allows all Deductions.
- 3: Is electric power deductible or is the lease silent? If yes, the “Yes” goes in the first column—Allows all Deductions.
- 4: Is there a specific prohibition against all deductions? If yes, the “Yes” goes in the second column—Allows No Deductions.
- 5: Are some items allowed and others not allowed? If yes, the “Yes” goes in the third column—Allows Some Deductions.



LEASE, WELL OR UNIT?

Ask your accountant which “lowest common denominator” your company uses, the lease level, the well level or the unit level?

You will build a spreadsheet for each lease (or well or unit).



DEDUCTIONS SPREADSHEET

OVERVIEW

Build a spreadsheet format in Excel or other spreadsheet Program that runs on your company's software suite.



SAMPLE (For hypothetical lease, LEASE TX 891)

<u>LINE ITEM</u>	<u>ALLOCATION</u>	<u>NOT DEDUCTIBLE</u>	
Chemical	100		
Communications	30	Bank Expense	0
Dehydration of Oil	100	Drilling	0
Electricity	100	Engineering	0
Environmental Compliance	100	Geological & Geophysical	0
Gas Treating	100	Legal	0
General and Administrative	30	Plug & Abandon	0
Insurance	30	Production Equipment	0
Metering	100	Rods and Tubulars	0
Permits, licenses	100	Royalty Payment (accounting)	0
Salaries (Company)	30	Water Injection	0
Salaries (Contract)	30	Well Pulling & Workover	0
Taxes (Mineral)	100		
Taxes (Severance)	100		
Vehicles	30		
Wastewater Disposal	100		



ADD AMOUNTS

For a sample month.

LINE ITEM	ALLOCATION	EXPENSE (\$)	NOT DEDUCTIBLE	
Chemical	100	2,000		
Communications	30	200	Bank Expense	0 100
Dehydration of Oil	100	500	Drilling	0 9,000
Electricity	100	4,000	Engineering	0 1,000
Environment Compliance	100	200	Geological & Geophysical	0 1,000
Gas Treating	100	100	Legal	0 500
General and Administrat	30	1,500	Plug & Abandon	0 500
Insurance	30	300	Production Equipment	0 1,500
Metering	100	100	Rods and Tubulars	0 1,000
Permits, licenses	100	200	Royalty Payment (accounting)	0 1,000
Salaries (Company)	30	6,000	Water Injection	0 3,000
Salaries (Contract)	30	2,000	Well Pulling & Workover	0 6,000
Taxes (Mineral)	100	300	SUB-TOTAL	24,600
Taxes (Severance)	100	600		
Vehicles	30	400		
Wastewater Disposal	100	1,000		
SUB-TOTAL		19,400		

NOTE: Your company's or client's accountants may divide up annual expenses such as property tax into monthly chunks.



ADD “PROGRAMMING”

Show the amount to deduct by multiplying the allocation by the expense.

LINE ITEM	ALLOCATION	EXPENSE(\$)	DEDUCT	NOT DEDUCTIBLE			
Chemical	100	2,000	2,000	Bank Expense	0	100	0
Communications	30	200	60	Drilling	0	9,000	0
Dehydration of Oil	100	500	500	Engineering	0	1,000	0
Electricity	100	4,000	4,000	Geological & Geophysical	0	1,000	0
Environment Compliance	100	200	200	Legal	0	500	0
Gas Treating	100	100	100	Plug & Abandon	0	500	0
General and Administrat	30	1,500	450	Production Equipment	0	1,500	0
Insurance	30	300	90	Rods and Tubulars	0	1,000	0
Metering	100	100	100	Royalty Payment (accounting)	0	1,000	0
Permits, licenses	100	200	200	Water Injection	0	3,000	0
Salaries (Company)	30	6,000	1,800	Well Pulling & Workover	0	6,000	0
Salaries (Contract)	30	2,000	600	SUB TOTAL		24,600	0
Taxes (Mineral)	100	300	300				
Taxes (Severance)	100	600	600				
Vehicles	30	400	120				
Wastewater Disposal	100	1,000	1,000				
SUB TOTAL		19,400	11,320	GRAND TOTALS		44,000	11,320



POSSIBLE OTHER COLUMNS Include:

LINE ITEM	ALLOCATION	EXPENSE(\$)	DEDUCT	DAILY PER BBL [ded/30] [ded/bbls sold]	NOT DEDUCTIBLE			
Chemical	100	2,000	2,000		Bank Expense	0	100	0
Communications	30	200	60		Drilling	0	9,000	0
Dehydration of Oil	100	500	500		Engineering	0	1,000	0
Electricity	100	4,000	4,000		Geological & Geophysical	0	1,000	0
Environment Compliance	100	200	200		Legal	0	500	0
Gas Treating	100	100	100		Plug & Abandon	0	500	0
General and Administrat	30	1,500	450		Production Equipment	0	1,500	0
Insurance	30	300	90		Rods and Tubulars	0	1,000	0
Metering	100	100	100		Royalty Payment (accounting)	0	1,000	0
Permits, licenses	100	200	200		Water Injection	0	3,000	0
Salaries (Company)	30	6,000	1,800		Well Pulling & Workover	0	6,000	0
Salaries (Contract)	30	2,000	600		SUB TOTAL		24,600	0
Taxes (Mineral)	100	300	300					
Taxes (Severance)	100	600	600					
Vehicles	30	400	120					
Wastewater Disposal	100	1,000	1,000					
SUB TOTAL		19,400	11,320		GRAND TOTALS		44,000	13,320



ADD SPREADABLES, IF APPLICABLE

INSERT MORE LINE ITEMS in your spreadsheet for Spreadable categories. Amount is the sum allocated to that lease for each Spreadable line item.

Assign deductions allocation—same as similar types from the original spreadsheet.



<u>LINE ITEM</u>	<u>ALLOCATION</u>	<u>EXPENSE(\$)</u>	<u>DEDUCT</u>
Chemical	100	2,000	2,000
Communications	30	200	60
Dehydration of Oil	100	500	500
Electricity	100	4,000	4,000
Environment Compliance	100	200	200
Gas Treating	100	100	100
General and Administrat	30	1,500	450
Insurance	30	300	90
Metering	100	100	100
Permits, licenses	100	200	200
Salaries (Company)	30	6,000	1,800
Salaries (Contract)	30	2,000	600
Taxes (Mineral)	100	300	300
Taxes (Severance)	100	600	600
Vehicles	30	400	120
Wastewater Disposal	100	1,000	1,000
<i>Field Superintend (allocated)</i>	<i>30</i>		<i>200/</i>
<i>Field Office</i>	<i>30</i>		<i>100</i>
SUB TOTAL		19,400	13,620
NOT DEDUCTIBLE [ADD SAME ITEMS AND AMOUNTS AS ABOVE]			
SUB TOTAL		24,600	0
GRAND TOTALS		44,000	13,620



PROPORTIONATE REDUCTION

- The deduction number is 100% of deductible expenses, but the royalty owners pay only their proportionate share of those expenses. So for the sample above, royalty owners sharing a 1/6th lease would pay their part of \$13,620, or \$2,267.12 divided among them.
- Accounting can input this number in their 'tax' slot.



PAYMENT DECKS AND SOFTWARE SLOTS

DECK PROTOCOL

Most 'royalty' decks contain a line or two for payment of the operator along with a bunch of lines for royalty and ORRI payees.

<u>PAYEE</u>	<u>NET REV INT</u>
Jane Jones	.08333
Joe Jones	.04167
John Jones	.02083
Suspense	.02083
XYZ Oil Co.	.83333
Total	1.00000



DEDUCTIONS

Most software contains at least one 'slot' where the total amount of property tax can be inserted. The program then parcels such cost out among the owners in that lease, well or unit which are listed in that deck.

<u>PAYEE</u>	<u>NET REV INT</u>	<u>DEDUCT TAX \$1,000.</u>
Jane Jones	.08333	\$83.33
Joe Jones	.04167	\$41.67
John Jones	.02083	\$20.83
Suspense	.02083	\$20.83
XYZ Oil Co.	<u>.83333</u>	<u>\$833.33</u>
Total	1.00000	\$1,000.00



SUBTRACTED

Amounts of deductions are subtracted from each royalty owner's gross royalty to get a net amount for their royalty.

GROSS REV	PAYEE	N R I	AMT	DED TAX \$1,000.	NET PAY
\$20,000.	Jane Jones	.08333	\$ 1,666.60	\$ 83.33	\$ 1,583.27
\$20,000.	Joe Jones	.04167	\$ 833.40	\$ 41.67	\$ 791.73
\$20,000.	John Jones	.02083	\$ 416.60	\$ 20.83	\$ 395.77
\$20,000.	Suspense	.02083	\$ 416.60	\$ 20.83	\$ 395.82
\$20,000.	XYZ Oil Co.	.83333	\$16,666.66	\$833.33	\$15,833.33
	Total	1.		\$1,000.00	



CAPS AND HOLDOVER

LIMIT DEDUCTIONS

To a maximum of 25% of the GROSS royalty for crude, dry gas and gas liquids.

Gross Month Sales for Lease	\$300,000.
Royalty %	16.667
Gross Royalty	\$50,000.
Expenses	\$230,000.
Deductions	\$100,000.
Sales Minus Deductions	\$200,000.
Deduct from Royalty	\$ 16.667.
Net Royalty after Deductions	\$ 33,333.

NO! STOP!



INSTEAD...

Add a column to your SUMMARY SPREADSHEET (see that page below).

Program that column to multiply REVENUE by 25%, or your chosen cap rate.

Label that column “CAP”.

Add another column in your SUMMARY SPREADSHEET to show the excess.

Label that column “HOLDOVER”



Numbers are now:

Gross Month Sales for Lease	\$300,000.	same
Royalty %	16.667	same
Gross Royalty	\$50,000.	same
Expenses	\$230,000.	same
Deductions	\$100,000.	same
Sales Minus Deductions	\$200,000.	same
Deduct from Royalty	\$16.667 <i>BUT <u>CAPPED</u></i> <i>at 25% of 50,000.,</i> <i>SO \$12,500.</i>	
Net Royalty after CAPPED Deducts	\$37,500.	
LEAVING HOLDOVER totaling	\$4,167.	



HOLDOVER

Deductions not taken may be documented and may be the subject of an accounting correction in a later month when deductible expenses are below 25%.

Set up and program a little spreadsheet with this information:

LEASE TX 891

MO/YR	\$ HOLDOVER ADDED	\$ HOLDOVER USED	\$ REMAINING
-1/18	6,000	0	6,000
02/18	0	2,000	4,000
03/18	4,167	0	8,167



ADD FOOTNOTES

ADD COLUMN

Add to your spreadsheet
coded to the following key.

Add the key to the bottom of
your Deductions
spreadsheet.



NOTES

- 1: NC = NOT Chargeable to the Lessors
- 2: Dehydration, heating.
- 3: Gas separation, gas treating to purchaser's specifications, waste gas disposal.
- 4: Gas liquids cooling, compressing.
- 5: Chemical incl de-sulphur, emulsifier, anti-corrosive, bacteriacide, scale block
- 6: Regulatory permits, licenses, inspections, filings and fees.
- 7: Environmental permits, licenses, inspections filings and fees.
- 8: Wastewater cleaning, hauling, disposal.
- 9: Property (ad valorem; 'school') tax.
- 10: Severance tax.
- 11: Business tax, fire tax, plugging fund tax, other.
- 12: Electricity, if lease allows OR if governmental agency mandates use of electric motors.
- 13: Transportation, metering, calibrating meters.
- 14: Marketing.
- 15: Other post-production, tax, regulatory and environmental functions.



FINISHED DEDUCTIONS SPREADSHEET

HEADER

Insert in the header of your
LEASE spreadsheet:

*Lease name,

*Month and Year,

*Total Revenue, and

*Total BOE (barrels of oil plus
gas at 10 to 1) SOLD, not produced.



COLUMNS

Spreadsheet columns under the header may include:

A Line Items (Chart of Accounts)

B. Expense (for that month, from Accounting)

C. Allocation (percentage deductible)

D. Deduction (Col. B times Col. C)

E. Daily Deduction (D/30)

F. Per BOE Deduct (D/total BOE listed in header)

G. Footnotes

Tell the program to total each of the columns B, D and F.



BOTTOM LINE

Amount to deduct for that Lease (or unit or well) for that month is the total of column D. GIVE THAT NUMBER TO ACCOUNTING.

CHECK

Compare the total Expenses (Column B) to total deductions (Column D). Expenses should be bigger than deductions. How much bigger will normally range from 20% to 200% more, depending on the type of production. Deductible expenses for gas properties are usually much lower than for oil. Expenses for low water-cut properties are usually much lower than for high water-cut.

Column F total should range from about \$3 to \$15 per BOE, depending on the type of production.



NEW SUMMARY SPREADSHEET

PREPARE SUMMARY SS

This spreadsheet will accumulate deductions for a bunch of Leases (or units or wells). Accounting and management will appreciate having all the Nodes for a county or a field in one report.

A	Lease Name [or well or unit]
B	Revenue [from purchaser(s)]
C	Severance Tax [already paid by purchaser(s)]
D	Net Payment [from purchaser(s)]
E	Holdover from Last Month
F	Deductions [for this month for that lease, unit or well]
G	Cap [(D minus E) times .25]
H	Holdover [E minus F] [into next month Col E]
I	Amount to Deduct [E minus G]

Tell the program to total each of the Columns B through I.



IMPLEMENTATION

NOTICE

UNLESS your company or client is already deducting for items beyond tax, you must prepare a notice to include with the next royalty check mailout. This goes at least one month BEFORE you actually start deducting.



WORDING

Use wording such as:

It has come to the attention of _____ (“ ”) that it has inadvertently failed to deduct from royalty payments the royalty owner’s share of “post-production expenses”, including oil treating, power, personal property taxes on mineral interests and regulatory costs, as well as applicable deductions for insurance and labor. Consent for such deductions are described in the oil and gas lease for which you are a payee, and in adjudication in _____ courts. Relevant court cases include:

(list cases in your State)

Please be advised that _____ will commence such deductions within 60 days.

If you have questions, please contact _____ .



GET EXPENSES

Request expense figures for each property from Accounting

PREPARE SPREADSHEETS

Build:

- * Spreadsheets (if needed)
- * Deductions (for each lease, well or unit), and
- * Summary (for groups of properties.)

GIVE TO ACCOUNTING

For insertion into the deductions slots in the royalty payment program. Stand by for questions.



REALITY CHECK

300 BOPD X 30 days X \$50 = \$450,000 Revenue

Gross Royalty = \$75,001.50 (1/6th)

Gross Deductions = \$150,000 for that month. SO:

Revenue	\$450,000	\$450,000 x .16667 =
	<u>-\$150,000</u>	\$ 75,001.50
	\$300,000	-\$150,000 X .16667 =
	X .16667	\$25,000.25 =
	= \$50,001	\$50,001
Cap at 25%	= \$18,750.38	Cap at 25% = \$18,750.38



GATHER KUDOS

REPORT

Report your deductions savings to management monthly.

Share the credit with Accounting.



RELATED MATTERS

MIXED UNIT?

Set up a unit with a mix of leases (deductions allowed; deductions not allowed) by adding another column which returns what would ordinarily be deducted to that particular well or lease, yielding \$0 for that lease's deduction.



SUMMARY FOR UNIT: Blackwell

DATE: March, 2018

PRODUCTION: 1,500

BOE REVENUE: \$75,000

<u>LEASE</u>	<u>\$ DEDS</u>	<u>\$ RETURN</u>	<u>\$ NET DED</u>
(from Deds Spreadshts)	(from Deds Spreadshts)	(New col in Summary SS)	(New col in Summary Spreadsheet)
Deds OK	5,000	0	5,000
Deds OK	7,000	0	7,000
No Deds	4,000	4,000	0
Deds OK	2,000	0	2,000
No Deds	6,000	6,000	0
TOTALS	24,000	10,000	14,000 actual deductions from leases 1, 2 and 4

Provide the numbers in the right column to Accounting for this month for this Unit.



PURCHASER DISBURSES

If your purchaser(s) disburse royalty, you may need to enter an agreement with them for you to furnish a dollar amount per lease (or unit or well) monthly so they can deduct that before disbursing to royalty owners. You will probably have to indemnify them.

YOUR WI BELOW 100%

If your company or client operates and pays royalties or supervises royalty payment, should you calculate deductions for the leases that they contributed to the well or unit? You can either:

- *Deduct for only your own leases, or
- *Offer your WI partners the option.

Recommend you deduct for your leases ONLY.
Recommend you do NOT deduct for your partner's leases unless you wish to meet with them and sell them on the idea.



OVERRIDING ROYALTIES

ORRI's follow the lease language to which they are attached, so if you can determine which lease is burdened by a particular override, then you can label that.

ROYALTY DECKS

If your company's or client's payment decks include only royalty and ORRI payees, and NOT the company's or other Working Interest owner shares, you will need to input the ROYALTY SHARE ONLY of deductions. So for \$50,000.00 in GROSS deductions in Your Summary Spreadsheet at 1/6th (16.667%) royalty, you would hand Accounting a number of \$8,335.00 for the royalty and ORRI owners only.

ARE DEDUCTIONS SAFE?

Yes, IF DONE CORRECTLY. Companies who withhold half the royalty payment, *even if the numbers justify that*, invite litigation.

Resist demands to deduct over 25%, at the maximum.



RETROACTIVE DEDUCTIONS

May be calculated for past months with 2 limitations, whichever is most recent.

Those are:

- * Your company's purchase of the lease, well or unit, or 4 years back.
- * You may correct past overpayments, starting with the oldest (to establish the time). **HOWEVER**, do NOT exceed 25% **TOTAL** deductions. Instead, add the excess to Holdover, as shown above.

LABEL EACH PAYEE?

You may be able to add a column to your company's or client's payment decks which, with expert programming, will tell the computer which accounts to deduct from and which not.



ESTOPPEL

Are you estopped from deducting because of your long and accepted practice of not deducting?

NO, per *Atlantic Richfield Co. v. State of California*, 214 Cal. App. 3rd 533, 541 (Cal. App. 1989).

Lessor California State Lands sued to reverse deductions taken by ARCO after they bought a platform off Santa Barbara. ARCO recompleted wells from a gas zone to a heavy oil zone. Gas deductions were so low that the previous owner did not bother. Court ruled that estoppel did NOT apply because the conditions changed.

Generalizing from that conclusion, changes over time such as:

- *Increasing regulatory burdens, and
- *higher water cut with consequent water handling costs,
- *recompletions, etc.

will DEFEAT laches because the original production conditions changed.



CAPITAL COSTS

The only capital costs for which deductions may be made are those expended for facilities downstream of the wellhead. These may include tanks, sales pipeline, heater treater, loading rack and the like. Include these as separate line items in your deductions spreadsheet.

Deduct on the IRS 5-year depreciation schedule; at 1.667% per month, for 60 months.

Note the end date so you do not overrun that time.

FREE FUEL?

The free fuel clause has no effective bearing on deductions. However, it is a talking point with landowners which indicates that not everything coming out of the well is subject to royalties.



ROUTE COMPLAINTS TO ...

YOU!

You have the expertise to reason with the landowners.

- Explain deductions.
- Read the deduction language in their lease to them.
- Read excerpts from the appellate decisions in your State regarding deductions.

Speak gently. They do not know what is happening.



★ REGARDS
ROYALTY
DEDUCTIONS

2964

LA INDIAN SCITTOOL
DIST

SUBSURFACE OIL AND GAS LEASE

THIS LEASE AND AGREEMENT, made and entered into October 30, 1959 by and between the parties whose names are subscribed hereunto as Lessor on the Signature Page attached hereto, hereinafter called Lessor (whether one or more), and UNION OIL COMPANY OF CALIFORNIA, a California corporation, hereinafter called Lessee;

WITNESSETH: That Lessor, in consideration of One Dollar (\$1.00) and other valuable consideration in hand paid, the receipt and adequacy of which are hereby acknowledged, and of the covenants and agreements hereinafter contained on the part of Lessee to be kept and performed, by these presents does lease unto Lessee, its successors and assigns, exclusively, all that portion of the land hereinafter described LYING BELOW A DEPTH FIVE HUNDRED FEET (500') FROM THE SURFACE THEREOF (herein sometimes referred to as the "leased land") for the purpose of prospecting, exploring, mining, drilling and operating the leased land for oil, gas and other hydrocarbon substances, and producing, taking, treating, storing, removing and disposing of said substances from the leased land, with the right for such purposes to the free use of oil, gas and water from the leased land and the right to inject in the leased land gas, water or other fluids for purposes of pressure maintenance or secondary recovery of oil, gas and other hydrocarbon substances from the leased land and the right to conduct secondary recovery operations, together with all other rights necessary or convenient for any and all of said purposes, including but not limited to, rights of way and easements in, under and through the leased land. The land hereby leased for the purposes aforesaid is situated in the County of Los Angeles, State of California, and is more particularly described on the Signature Page attached hereto, and shall include such rights as Lessor may have in depths lying below 500 feet below the surface of any roads or streets traversing or adjoining the above described property.

This lease shall remain in force for a term of ten (10) years from the date hereof (hereinafter referred to as the "Primary Term"), and for so long thereafter as oil, gas or other hydrocarbon substances shall be produced from the leased land, or operations (including, but not limited to, drilling, deepening, plugging back, redrilling, repairing, cleaning out and similar operations) on the leased land or lands with which the leased land may be pooled, or shall be excused therefrom as hereinafter provided; provided, however, that so long as Lessee shall continue to drill wells within the intervals permitted in Paragraph 6 hereof, Lessee shall be deemed to be conducting drilling operations within the meaning of this provision.

In consideration of the premises, it is hereby mutually agreed as follows:

1. The term "royalty share" wherever used herein shall mean the fraction one-sixth (1/6).

2. Lessee shall pay to Lessor as royalty on oil the royalty share of all oil produced, saved and removed from the leased land. Lessee shall purchase Lessor's royalty oil at Lessee's public posted market price currently offered and paid in the field in which the leased land is located for oil of like gravity and quality the day the oil is shipped from the leased land. In the event there is no such public posted market price, Lessee shall purchase Lessor's royalty oil at the same price the company or companies purchasing the majority of the oil in the field in which the leased land is located shall be paying for crude oil of like gravity and quality. In the event Lessee shall treat the oil produced for the purpose of making the same marketable, Lessor shall pay the royalty share of the cost of such treating. In determining the gravity, quality and quantity of oil purchased, the methods and practices which are usual and customary among major oil purchasing companies shall be followed and the customary temperature corrections and deductions for injected oil, water and other foreign substances shall be made.

★ Lessee shall not be required to account to Lessor for or pay royalty on oil, gas or other hydrocarbon substances used by Lessee in its operations hereunder, including, but not limited to, fuel, lifting, injecting, gathering, compressing for processing and processing purposes, and Lessee may use such substances free of charge. In no event shall Lessee be liable to Lessor for its failure or inability to save any of said substances, or for shrinkage or loss thereof, and royalty shall not be payable in respect to any of such substances lost through evaporation, leakage, fire or otherwise.

★ In the event Lessee in its operations hereunder shall substitute fuel or power for fuel obtainable from the leased land or land with which the leased land may be pooled, Lessee shall be entitled to deduct from the amount of increased royalty accruing therefor shall in any event exceed the amount of such increased royalty.

★ 3. Lessee shall pay to Lessor as royalty on gas the royalty share of the net proceeds derived from the sale of gas produced hereunder, after deducting delivery costs, and also the royalty share of the value at the field market price of any gas used by Lessee in operations other than those conducted under this lease. Nothing in this agreement contained, however, shall require Lessee to save or market gas from the leased land unless there shall be a surplus above lease requirements and a market at the well for the same.

★ Lessee shall have the right to treat or cause to be treated all or any portion of the gas produced from the leased land for the purpose of extracting gasoline or other content thereof, and for such purpose Lessee may transport or cause to be transported to a gasoline extraction plant on other land all or any portion of such gas where it may be commingled with gas from other properties. Lessee shall meter such gas so transported and such meter readings together with tests made of the gasoline and other content of such gas at approximately regular intervals, at least once each month, shall furnish the basis for computation of the amounts of such gasoline or other hydrocarbons, and of the residue gas to be credited to this lease. Gas actually and reasonably used or consumed or lost in the operation of any such extraction plant shall be free of charge and Lessee shall not be held accountable to Lessor for that proportion of the gas so used, consumed or lost which, on the basis of the quantity determinations made as above stated, is reasonably estimated to come from the leased land.

★ 4. In the event Lessee shall extract in a plant operated by it gasoline or other hydrocarbons from the gas produced from the leased land, Lessee shall pay Lessor as royalty forty per cent (40%) of the Lessor's royalty share of the value, as herein-



after defined, of the gasoline or other hydrocarbons credited to this lease from the gas so treated. The value of such gasoline or other hydrocarbons shall be deemed to be the value of such gasoline or other hydrocarbons at prices currently offered and paid by major purchasers for gasoline or such other hydrocarbons of like specifications and quality in the district. If gasoline or other hydrocarbons is extracted by a third party on a basis whereby a royalty is reserved to Lessee, then Lessor shall be entitled to the value of Lessor's royalty share of such reserved royalty.

5. On or before the last day of each month, Lessee shall render a statement of production to Lessor in the manner provided in Paragraph 22 hereof, with respect to all royalties payable to Lessor for the preceding calendar month, which statement shall be accompanied by a check for the amount so shown to be payable to Lessor on account of royalties for said preceding calendar month. Each such statement shall be deemed to be an account stated between the parties unless specific written objection be made thereto by Lessor within six (6) months after delivery thereof.

6. Lessee has paid to Lessor rental in full hereunder for a period of two (2) years from the first day of the month following the month in which delivery of this lease was made as shown on the Signature Page attached hereto. This lease shall terminate as to all rights and obligations created hereby unless Lessee shall make or tender the payments hereafter provided or shall within said period commence drilling operations for a well for oil and gas to be bottomed in the leased land or lands with which the leased land may be pooled and prosecute the drilling of such well with reasonable diligence until oil or gas is found in quantities deemed paying by Lessee or until Lessee deems that further drilling would be unprofitable or impracticable in which event Lessee may abandon such well. In the event Lessee shall not have commenced such drilling operations on or before the expiration of such period, Lessee may, at its option, from time to time defer the commencement of drilling operations within the primary term hereof by the payment or tender to Lessor of an annual rental equal to the sum paid to Lessor on the execution hereof, payable semi-annually in advance, and such payments shall operate to defer the obligation to commence drilling operations during any period for which rental is paid. All payments or tenders may be made by check or draft of Lessee mailed or delivered on or before the rental payment date. It is the intent hereof that rentals shall not be paid under this Paragraph 6 except for the purpose of deferring the commencement of drilling operations as herein provided.

In the event of abandonment of any well prior to the discovery of oil or gas upon the leased land in quantities deemed paying by Lessee, Lessee shall within six (6) months thereafter commence drilling operations for a new well for oil and gas to be bottomed in the leased land or lands with which the leased land may be pooled and thereafter prosecute the same diligently as above provided and, in the event of abandonment thereof, continue the drilling of wells in like manner and within like intervals until oil or gas is discovered in the leased land or lands with which the leased land may be pooled in quantities deemed paying by Lessee or until this lease is terminated. Prior to discovery of oil or gas on the leased land or lands with which the leased land may be pooled in quantities deemed paying by Lessee, Lessee may defer the commencement of further drilling operations (except offset wells) during any period for which rentals have theretofore been paid or until six (6) months after the abandonment of the last preceding well, whichever is the later, and so long thereafter as Lessee continues the payment of rentals on a monthly basis in the manner and at the rate above provided but in no event shall the commencement of drilling operations be deferred beyond the expiration of the primary term by the payment of such rentals.

7. Within six (6) months after the completion and testing of a well producing oil in quantities deemed paying by Lessee, Lessee shall commence drilling operations for another well for oil and gas, and thereafter continuously operate one string of tools, allowing six (6) months (subject to extension as hereinafter provided) between the completion or abandonment of one well and the commencement of drilling operations for the next succeeding well until one well has been drilled for each twenty (20) acres, or major fraction thereof, of the leased land or land with which the leased land may be pooled; provided, however that if and when drilling on the leased land or lands with which the leased land may be pooled shall indicate that oil cannot be produced therefrom in quantities deemed paying by Lessee but that gas can be produced in quantities deemed paying by Lessee the obligation of Lessee hereunder shall be to drill only one well for each one hundred sixty (160) acres, or major fraction thereof; the number of wells to be an average of one to twenty (20) acres for oil wells and one to one hundred sixty (160) acres for gas wells, regardless of where drilled; provided, however, that for all purposes of this lease a well drilled by Lessee in the leased land or lands with which the leased land may be pooled to a depth greater than six thousand five hundred feet (6,500') beneath the surface shall be deemed to be two (2) wells. Lessee shall be given credit for so much of the time in each such six (6) months drilling interval as is not utilized because of drilling by Lessee sooner than required and such credit may be used to extend subsequent drilling intervals in such manner as Lessee may determine. Lessee may drill as many additional wells as it may elect in excess of the number hereinabove specified. Lessee shall not be obligated to use more than one (1) string of tools for drilling on the leased land or lands with which the leased land may be pooled.

8. If at any time during the term of this lease oil is discovered in any well drilled on adjacent property not owned by Lessor and within three hundred thirty feet (330') of the exterior limits of any land at the time embraced in this lease, or gas and not oil is discovered in any well drilled on adjacent property not owned by Lessor and within six hundred sixty feet (660') of such exterior limits, and said well produces oil, if within three hundred thirty feet (330'), or gas, if within six hundred sixty feet (660'), in quantities deemed paying by Lessee for thirty (30) consecutive days and a well offsetting the same is not already drilled or being drilled, then Lessee shall within sixty (60) days after expiration of such thirty (30) day production period of said well to be offset, commence drilling operations for a well to offset said well and drill the same diligently to the zone from which oil or gas is being produced from said well to be offset. Offset wells for oil shall be located within three hundred thirty feet (330') of the boundary line separating the properties, and within six hundred sixty feet (660') of the prolongation of a line drawn from the well to be offset across said boundary line at right angles. Offset wells for gas shall be located within six hundred sixty feet (660') of the boundary line separating the properties, and within one thousand three hundred twenty feet (1,320') of the prolongation of a line drawn from the well to be offset across said boundary line at right angles. Notwithstanding any provisions to the contrary contained herein, Lessee shall have the right to locate offset well so as to conform to the regular spacing program established within the field in which the leased land is located. "Quantities deemed paying by Lessee" as used in this paragraph shall be considered production that will be sufficient to assure Lessee a reasonable profit



over and above the cost of drilling and producing such an offset well and including royalties, taxes and other charges in respect thereto. In event Lessee determines that an offset well cannot be profitably drilled, it shall so notify Lessor in writing and surrender to Lessor, if Lessor so requests, the right to produce oil and gas from a ten (10) acre parcel of the zone underlying the leased land from which the well to be offset is being produced and thereupon Lessee shall be relieved of its obligations hereunder with regard thereto.

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9. After completion of the first well herein required, there shall be no obligation upon the part of Lessee to drill in or produce from and operate the leased land for oil, except as to offset wells when wells offset are being operated, so long as the market price in the field for oil of the quality and gravity produced on said property shall be One Dollar (\$1.00) or less per barrel at the well. Lessee may at any time and from time to time suspend the production of gas from the leased land, but for any period during which such production is entirely suspended, oil not having been discovered in quantities deemed paying by Lessee in the leased land, Lessee shall pay to Lessor quarterly in advance, commencing on the first day of the month following such suspension, as advance royalty, the sum of Twenty-five Cents (25¢) for each acre of the leased land then covered by this lease and Lessee shall have the right to reimburse itself for any such payment out of one-half (½) of any royalties which shall thereafter become payable hereunder. Such production may not be suspended, however, when there is a market for the gas in the field at a price which will pay Lessee to drill for and produce the same with a reasonable profit.

10. Lessee shall carry on all operations in a careful, workmanlike manner and in accordance with the laws of the State of California. Lessee shall keep full records covering the production and sale of gas, oil, and natural gasoline from the leased land, and such records shall be open at all reasonable times to the inspection of Lessor or Lessor's duly authorized representative.

11. Lessee agrees, subject to the other provisions of this lease, to operate each completed oil or gas well with reasonable diligence and in accordance with good oil field practice so long as such well shall produce oil or gas in quantities deemed paying by Lessee; provided, however, that Lessee shall not be obligated to remove any oil, gas or other hydrocarbon substances produced from the leased land by any means other than a subsurface pipe line. Lessee shall not be obligated to construct a pipe line to remove such oil, gas or other hydrocarbon substances so long as Lessee is removing such oil, gas or other hydrocarbon substances by any other means, or if other means for such removal are not available or permitted by governmental agencies unless and until the daily production from all wells drilled in the leased land or lands with which the leased land may be pooled shall be in excess of two thousand (2000) barrels a day averaged over any thirty (30) day consecutive period. Operations to construct such pipe line shall be commenced within sixty (60) days after such production has so averaged two thousand (2000) barrels a day over any such thirty (30) day consecutive period unless Lessee shall be required to secure from any federal, state, county or municipal body or agency, or more than one of them, a permit therefor, in which event Lessee shall apply for such permit within said sixty (60) day period and commence such construction operations within thirty (30) days after such permit shall have been granted by the last of such federal, state, county or municipal bodies or agencies which require such permit. In the event such permit shall not be granted, then Lessee shall not be obligated to remove such production until such time as other arrangements can be made for the removal of the same without unreasonable delay.

★ 12. All work done on the leased land by Lessee shall be at Lessee's sole cost and expense, and Lessee agrees to protect said land and Lessor from claims of laborers and materialmen resulting from Lessee's operations hereunder, and Lessor may post and keep posted on said land such notices of nonresponsibility as Lessor may desire to protect said lands against liens.

13. In consideration of the payment made by Lessee to Lessor for the execution of this lease, it is agreed that Lessee may at any time, or from time to time, either before or after discovery of oil in the leased land, quitclaim this lease, either in its entirety or in part, and thereupon Lessee shall be released from all further obligations as to the part or parts so quitclaimed, and all rentals and drilling obligations as set forth in this lease shall be reduced pro rata according to the amount of acreage so quitclaimed by Lessee; it being particularly understood, however, that all lands so quitclaimed shall remain subject to—and Lessee shall have the right to use and enjoy—such rights of way and easements in, under, and through the quitclaimed portion of the leased land as may be necessary or convenient, in whole or in part, for Lessee's operations on the land retained under this lease; provided, however, that any well drilled through any such quitclaimed portion of the leased land shall have no part of its producing interval in such quitclaimed portion.

★ 14. Lessee shall pay all taxes levied on its improvements and personal property. Lessor shall pay all taxes and assessments on the leased land, exclusive of Lessee's mineral rights therein, and on all other improvements and personal property thereon. All increase in the taxes and assessments on the leased land or, if Lessee shall have quitclaimed a portion thereof, on such part thereof as is retained by Lessee under this lease, caused by or resulting from the discovery or production of oil, gas or other hydrocarbon substances thereon and therefrom, whether assessed upon the leased land as a whole or as mineral rights or otherwise, and all charges and taxes of whatsoever kind or collected by reason of the production, sale or removal of oil, gas or other hydrocarbon substances from the leased land shall be borne by the parties hereto in the proportion of the royalty share by Lessor and the remainder by Lessee. If Lessor shall fail to pay any taxes, assessments or charges required to be paid by Lessor, Lessee may at its option pay the same and in such event Lessee may reimburse itself for such taxes, assessments or charges so paid by it from any royalties or rentals accruing hereunder.

15. On the expiration of this lease, or its sooner termination, Lessee shall quietly and peaceably surrender possession of the premises to Lessor, and shall cause a good and sufficient quitclaim deed to be placed of record in said County.

16. In case of default in performance by Lessee of any of its obligations under this lease, and the failure to commence to remedy the same within sixty (60) days after receipt of written notice so to do signed by parties owning a majority of Lessor's interest or in the event the leased land is pooled with other lands as provided in paragraph 25 hereof by parties owning a majority of the landowners' interest in all the lands so pooled, specifying the particulars in which it is claimed Lessee is in default and thereupon to continue such remedying with reasonable diligence to completion, then at the option of Lessor all rights of Lessee under this lease shall forthwith cease and terminate except that Lessee shall have the right to retain all wells then



or as to particular parts of the leased land, such division or severance of the lease shall constitute and create separate and distinct holdings under the lease of the several portions of the leased land as thus divided, and the holder of each such portion of the leased land shall be required to comply with and perform the Lessee's obligations under this lease for, and only to the extent of, his portion of the leased land; provided that nothing herein shall be construed to enlarge the drilling or rental obligations, and provided further that the commencement of the drilling operations and the prosecution thereof, as provided in Paragraph 6 hereof, either by the Lessee or any assignee hereunder, shall protect the lease as a whole.

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22. All statements of production and royalty and all payments to be made by Lessee to Lessor hereunder shall be sent to the persons whose names are hereunto subscribed as Lessor on the Signature Page attached hereto, respectively, at the addresses shown thereon. Lessee shall, upon notification of change of ownership in the lands or in rentals or royalties hereunder, as provided in Paragraph 21 hereof, divide and distribute the same to the new owners of such interests; provided, however, that at any time after royalty becomes payable hereunder, Lessee may, at its option, withhold payment of such rentals or royalties until parties owning a majority of Lessor's interest designate in writing a recordable instrument delivered to Lessee, a bank, trust company or corporation in California, as a common agent and depository, to receive all payments due hereunder to such persons. Such designation may be changed at any time in the same manner. Delivery of all statements and payments hereunder may be made by depositing the same in the United States mail duly addressed to Lessor at the above address or addresses or to such agent and depository which shall constitute full performance of Lessee's obligation to make such delivery. In the event that the amount payable under this lease shall result in a payment of less than Five Dollars (\$5.00) becoming due Lessor, Lessee may, at its option, withhold and accrue sufficient periodic payments until the total due Lessor exceeds Five Dollars (\$5.00).

23. Any notice herein required or permitted to be given or furnished by one party to the other shall be in writing. Delivery of such written notice to Lessor shall be made by depositing the same in the United States mail duly certified and addressed to Lessor at the address shown on the Signature Page attached hereto and delivery of such written notice to Lessee shall be made by depositing the same in the United States mail duly certified and addressed to Lessee at Union Oil Center, Los Angeles 54, California. Either party hereto may by written notice to the other party change its address to any other location.

24. Lessor hereby grants exclusively unto Lessee and its assigns such rights of way, easements and servitudes in, under and through the leased land as Lessee or its assigns may from time to time desire for boring well holes from surface locations outside the leased land in, under or through the leased land and for casing and otherwise completing and maintaining such wells and using the same for producing from other land, whether or not pooled with the leased land, such rights of way, easements and servitudes to continue for the duration of this lease and thereafter as hereinafter provided. If Lessee shall assign to any third party or parties rights granted to Lessee under this paragraph, the rights of Lessee shall not thereby be diminished, but in such event both Lessee and its assignee shall have, hold and enjoy said rights, each independently of the other. The rights of Lessee and of each assignee of Lessee under this paragraph shall continue after the expiration, surrender, forfeiture or other termination of this lease for a period of twenty (20) years from the date of this lease and so long thereafter as oil, gas or other hydrocarbon substances are produced by means of any such well or as drilling, redrilling or remedial operations are being conducted with respect to any such well. Lessee and each such assignee utilizing any such rights after the expiration, surrender, forfeiture or other termination of this lease shall pay to Lessor a rental for each well subsequently maintained by it under or through the leased land at the rate of One Dollar (\$1.00) per annum per foot of the horizontal projection (computed to the nearest part of a foot) of the surveyed course of the part of the well of such Lessee or assignee lying within the confines of the leased land, the rental with respect to any such well to commence on the completion thereof and to continue until such well is abandoned in accordance with the requirements of the State of California; provided, however, that Lessor shall not be entitled to receive any rental under the provisions of this paragraph during such times as Lessor is entitled to receive royalty or rentals under other provisions of this lease. During the term of this lease, Lessor shall not grant any rights of way, easements or servitudes in and to the leased land in respect to the drilling for or the production of oil, gas, hydrocarbons and associated substances to any other person, firm or corporation without the written consent of Lessee.

25. Lessee is hereby given the right at its sole option, by a written declaration of pooling, at any time or from time to time, to combine or pool all or any part of the leased land with all or any part of any other tract or tracts of land, either adjoining the leased land or in the immediate vicinity thereof, so as to create by such combining or pooling one or more operating units for the production of oil, gas or other hydrocarbon substances, any such single unit not substantially to exceed one hundred sixty (160) acres in area for oil and six hundred forty (640) acres in area for gas; provided, however, that the designation of such unit shall be made prior to thirty (30) days after the completion of a well for oil and gas on the lands to be pooled and shall define the area which shall constitute the pool. In the event and as soon as any such oil or gas unit is so created, Lessee shall promptly record in the office of the county recorder in the county in which said land is situated such written declaration of pooling and Lessee shall give written notice of such pooling to Lessor. In the event there shall be lands within the boundaries of the unit which are not owned by or leased to Lessee, but Lessee should thereafter acquire an oil and gas lease on such lands, then Lessee may, at its option, by a supplemental declaration of pooling include such additional land and lease in such unit, but no retroactive adjustment of royalties shall be made. Lessor agrees that in the event production of oil, gas or other hydrocarbons is obtained from any lands included within any such unit, whether or not from lands covered by this lease, there shall be allocated to the lands covered by this lease and included in such unit, for the purpose of royalty determination, only that proportion of the entire production from such unit that the amount of Lessor's surface acreage in such unit bears to the total surface acreage in such unit, and royalty payable under this lease with respect to leased land included in such unit shall be computed only on that portion of such production so allocated to such leased land, such allocation shall be deemed to be the equivalent of producing oil, gas or other hydrocarbon substances for the purpose of prolonging the term of this lease as to that portion of the leased land included within such unit. For the purpose of determining drilling obligations in such unit, which shall be at least equal to the drilling obligations set forth hereinabove in this lease, the entire acreage so pooled shall be treated as if it were covered by one lease and the drilling of a well in any part of such unit, whether or not on land covered by this lease, shall fulfill



Lessee's drilling obligations under this lease to the same extent as if such well were drilled on land covered by this lease and no offset obligations shall accrue with respect to the several tracts of land included within any pooled unit. Upon the pooling of less than all of the land hereby leased, as hereinabove provided, this lease shall be severed and separately pooled acreage and unpooled acreage shall be segregated and constitute separate and distinct leaseholds, so that performance of the obligations of one shall validate that one regardless of any default in the other. Lessee may at any time quitclaim to the persons entitled thereto all or any part of the land in any such unit and thereupon Lessee shall be released from all further obligations with respect to land so quitclaimed and all drilling requirements thereunder shall be reduced pro rata and no owner of land in the unit not owning any interest in quitclaimed land except by virtue of such pooling shall have any interest in such quitclaimed land after the quitclaim is delivered or recorded. The payment of royalty hereunder, and the payment of royalty under any other lease covering land which was originally included within the unit, shall not be affected or reduced by any such quitclaim unless and until the quitclaimed land or some portion thereof shall be thereafter leased for oil or gas or the drilling of a well for oil or gas thereon shall be commenced thereon, or unless such quitclaim was made by reason of failure of title, whereupon all allocation of production to such quitclaimed land hereunder shall cease. Lessee may, at its sole option, at any time when there is no production in such unit of oil or gas in quantities deemed paying by Lessee, terminate such unit by a written declaration thereof, in the same manner in which it was created. Upon the termination of any such pool, if only a part of the leased land was included therein, this lease shall no longer be considered as separate and distinct leases and the effect of such termination shall be to return this lease to the status in which it was immediately prior to the creation of such unit as though no unit had been created. In the event any nonproductive well or wells shall be drilled under any such unit which is later terminated, such well or wells shall be deemed to have been drilled under and pursuant to the lease covering the land on which such well was bottomed, and all rights to casing therein or use thereof shall belong to the owner of the land in which such casing lies in accordance with the provisions of the lease or other agreement covering such land.

26. This agreement may be executed in any number of counterparts with the same force and effect as if all parties signed the same document. The execution hereof by any person named as Lessor herein shall bind such person's interest whether or not any other person named as Lessor herein shall execute the same.

27. The entire agreement between the parties is set forth in this lease, and no covenant or agreement, express or implied, other than those set forth in this lease, shall be binding upon either of the parties hereto except insofar as this lease may subsequently be modified by written agreement of the parties.

28. Subject to the provisions hereinabove set forth, this lease and agreement shall be binding upon and inure to the benefit of the heirs, successors in interest and assigns of the respective parties hereto.

29. NOTWITHSTANDING ANY PROVISIONS TO THE CONTRARY CONTAINED HEREIN, THIS LEASE AND ALL RIGHTS GRANTED TO LESSEE HEREUNDER ARE EXPRESSLY LIMITED TO THOSE DEPTHS LYING BELOW 500 FEET BELOW THE SURFACE OF THE LANDS DESCRIBED ON THE LESSORS' SIGNATURE PAGE HEREOF AND LESSEE SHALL NOT HAVE THE RIGHT TO ENTER UPON OR USE ANY PORTION OF SAID LANDS LYING ABOVE SAID DEPTH.

30. This Subsurface Oil and Gas Lease has been executed in duplicate and one executed copy of the "Lessors' Signature Page" is attached to the Lessors' copy of this Subsurface Oil and Gas Lease. It is agreed that the other executed copy of such signature page may be attached to an identical copy of this Subsurface Oil and Gas Lease together with other signature pages from other identical Subsurface Oil and Gas Leases executed by other Lessors for the purpose of recording the same.

IN WITNESS WHEREOF, the parties hereto have caused this lease to be executed the day and year first above written.

UNION OIL COMPANY OF CALIFORNIA

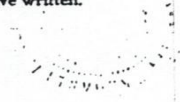
By J. E. Nohrden
Its Attorney-in-Fact LESSEE

STATE OF CALIFORNIA }
COUNTY OF LOS ANGELES } SS.

On November 4, 1959 before me, MARGARET I. YOUNG

a Notary Public in and for said County and State, personally appeared J. E. Nohrden
known to me to be the person whose name is subscribed to the within instrument, as the Attorney-in-Fact of UNION OIL COMPANY OF CALIFORNIA and acknowledged to me that _____ he subscribed the name of UNION OIL COMPANY OF CALIFORNIA thereto as principal and his own name as Attorney-in-Fact.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.



Margaret I. Young
Notary Public in and for said County and State.

My Commission Expires July 29, 1962



QUESTIONS?



Marlin Brown, CPL

buglegroup@yahoo.com

