

STATE LANDS COMMISSION

State of California

Oil and Gas Lease Extension and Renewal

THIS INDENTURE OF LEASE, Made and entered into this 22nd  
day of October, 1949, pursuant to Division 6 of the Public  
Resources Code and the provisions of Chapter 303 of 1921, Statutes of  
California, by and between the State of California, acting by and through  
the State Lands Commission hereinafter called the "State", and

BANKLINE OIL COMPANY

hereinafter called the "Lessee"; and

WHEREAS, the State deems the extension and renewal of Lease No.  
89, entered into pursuant to Chapter 303 of the Statutes of 1921,  
upon the terms and conditions herein set forth to be in the best interests  
of the State;

WITNESSETH: That the State in consideration of the rental and  
royalty to be paid and the covenants, conditions, agreements and stip-  
ulations herein contained does hereby grant extension and renewal of Lease No.  
89, for that certain tract of tide and submerged land, situate in  
the County of Santa Barbara, State of California, and more particularly

described as follows:

Beginning at a point on the ordinary high water mark of the Pacific Ocean, at the most easterly corner of the lands embraced in expired Lease No. 88 (303-1921), which point bears S. 54° 52' 30" E. 340.46 feet, S. 52° 28' 00" E. 1062.38 feet, S. 50° 34' 30" E. 258.19 feet and S. 50° 03' 30" E. 1.00 foot from Monument No. 8 as shown on a map entitled "State Leases and Permits, Elwood Oil Field," approved November 1, 1929, and filed in the office of the Division of State Lands; thence along said ordinary high water mark S. 50° 03' 30" E. 1092.33 feet to the most northerly point of the lands embraced in Lease No. 90 (303-1921); thence leaving said ordinary high water mark and running along the westerly side boundary line of the lands embraced in Lease No. 90 (303-1921), S. 39° 56' 30" W. 2730.82 feet; thence N. 50° 03' 30" W. 1092.33 feet to the easterly side boundary line of the lands embraced in expired Lease No. 88 (303-1921); thence along the said easterly side boundary line of the lands embraced in said expired Lease No. 88 (303-1921), N. 39° 56' 30" E. 2730.82 feet to the point of beginning;

and containing approximately 68.48 acres.

It is hereby expressly understood and agreed that said Lease No. 89, dated October 22, 1929, is hereby terminated and that all of the terms, conditions and provisions therein contained are hereby terminated and are of no further force and effect and that all of the terms, conditions and provisions of the extension and renewal of said Lease No. 89 pertaining to the use and occupancy of said tract of tide and submerged land by the Lessee are fully set forth and contained in this "Indenture of Lease".

The term of this extension and renewal of lease shall continue for a period of ten (10) years from and after the date hereof and provided such term may be thereafter extended upon such terms and conditions and for such period of time as and if the Legislature may provide. This Lease shall be subject to the following terms and conditions:

1. The Lessee shall have the sole and exclusive right to prospect for, drill for, produce, and take oil and gas only from the demised premises.

2. The Lessee agrees to pay the State annually in advance, as rental, the sum of \$342.40 which rental and any rentals for rights of way over State lands granted in connection herewith, shall be credited against the royalties, if any, as they accrue for the year for which such rental is paid; to pay to the State in money a royalty in accordance with the formula attached hereto, marked Exhibit B, and by reference made a part hereof, on the oil produced and saved from each well, or on demand, the State's royalty in oil, determined in accordance with said Exhibit B. When paid in money, the royalty shall be calculated upon the reasonable market price of the oil at the well as determined by the State, which price shall not be less than the highest price at which a major oil company then buying oil of like gravity and quality in substantial quantities at the Elwood Field in Santa Barbara County, California, is offering for oil of like gravity and quality at the well, and it shall be due and payable not later than the 25th day of the calendar month following the calendar month in which the oil is produced. Reasonable market price of the oil at the well is hereby interpreted to mean the reasonable market price at the well as determined by the State unless such oil is sold pursuant to a sales contract approved by the State as provided in Paragraphs 15 and 26 of this lease, which contract shall provide for the payment of not less than the highest price at which a major oil company, then buying oil of like quality and gravity in substantial quantities at the Elwood Field, is offering for oil of like gravity and quality at the well in which case the reasonable market value is hereby interpreted to mean the price set forth in such sales contract; plus any subsidy or extra payment which the Lessee, or any successor in interest thereto, may receive at any future time or at any time during the term of this Lease, without regard as to whether such subsidy or extra payment shall be in the nature of money or other consideration. When paid in kind, the royalty oil shall be delivered in the field and taken by the State at the receiving tanks of the Lessee on forty-eight (48) hours' notice by the Lessee that a tankful

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of oil will be ready for delivery. The Lessee also agrees to pay to the State, at the times and in the manner herein specified for the payment of royalty on oil, twenty (20) per centum of the gross market value, at Elwood, California, of all dry gas, natural gasoline and other products extracted and saved from the gas produced from the demised premises, provided, however, if the wet gas from the demised premises is delivered by the Lessee to a third party for processing on a contract or royalty basis, the royalty provided to be paid hereunder shall be twenty (20) per centum of the market value at the processing plant of the Lessee's proportion of the dry gas, natural gasoline and other products extracted and saved from the gas produced from the demised premises under such contract. The gross market value shall be the reasonable market value as fixed by the State, unless such dry gas, natural gasoline and other products are sold pursuant to a sales contract approved by the State.

Should the Lessee extract from the State's lands any products other than oil, gas or gasoline, the Lessee shall immediately report such fact to the State and shall pay to the State therefor a royalty to be mutually agreed upon by the parties hereto and which shall be based upon the gross market value of such products in the field when produced. Said gross market value shall be such reasonable market value as shall be fixed by the State.

The Lessee shall pay to the State the State's royalty share of any bonus received by the Lessee from the sale of any oil, gas, natural gasoline or other products produced hereunder.

The State may, at its option, take its wet or dry royalty gas, natural gasoline and any other products in kind. Delivery thereof to be made at a manufacturing plant located proximate to the demised premises where it can be processed or at such other place as the parties hereto may agree.

3. The State reserves the right to lease or otherwise dispose of the surface of the lands embraced within this Lease.

4. This Lease may not be assigned, transferred, or sublet, except with the written consent of the State and then only to a person, association

of persons, or corporation, who at the time of the proposed assignment, transfer or sublease, possesses the qualifications provided in Division 6 of the Public Resources Code, Statutes of California.

5. (a) This Lease may be surrendered and terminated in its entirety by the Lessee at any time without consent of the State upon the payment of all royalties and other obligations due and payable to the State, and provided that said Lessee has fully performed and complied with all the terms of said Lease up to the time of such surrender, but in no event shall such termination be effective until the Lessee has complied with all of the then existing laws and rules and regulations relative to the abandonment of oil and gas wells.

(b) This Lease may be surrendered and terminated as to any portion of the demised premises or as to any separate and distinct oil zone upon the payment of all royalties and other obligations due and payable to the State, but in no event shall such termination be effective until the Lessee has complied with all of the then existing laws and rules and regulations relative to the abandonment of oil and gas wells. The State shall require any quitclaim as to any portion of the demised premises or as to any separate and distinct zone to be in such form as to be in the interest of the State of California. In the event that the State determines that such quitclaim as to any portion of the demised premises or as to any separate and distinct zone would not be in the interest of the State of California, by reason of the fact that such quitclaim embraces land capable of producing oil and/or gas in commercially profitable quantities, and in the event that the Lessee hereunder determines that such refusal on the part of the State to accept Lessee's such quitclaim is unreasonable, then and in that event the State and the Lessee shall settle the matter by arbitration. Such arbitration shall be in accordance with either of the two following procedures:

- A. The parties hereto shall mutually agree upon a single individual who shall act as sole arbiter of any dispute or difference of opinion relating to or created by the State's refusal to accept a quitclaim whenever the State has determined that the acceptance of such quitclaim would not be in the best interests of the State of California.
- B. The parties hereto shall each select a representative to serve on a Board of Arbitration which shall consist of three members. The two members so selected shall apply to any Judge of the District Court of the United States, Southern

District of California, Central Division, who shall have the right to appoint the third member. The Board of Arbitration shall act as sole arbiter of any dispute of the difference of opinion relating to, or created by, the State's refusal to accept a quitclaim whenever the State has determined that such quitclaim would not be in the interest of the State of California.

(c) The findings and conclusions of either the single arbiter as provided by sub-paragraph "A" above or the findings and conclusions of a majority of the Board of Arbitration as provided by sub-paragraph "B" above, shall be conclusive and binding upon the parties hereto, together with their heirs, assigns, sublessees or successors in interest. Such findings or conclusions shall be reached within a period of sixty (60) days after the matter shall have first been referred to either the single arbiter as provided for in sub-paragraph "A" or the Board of Arbitration as provided for in sub-paragraph "B"; and in the event that such findings and conclusions have not been reached within said sixty (60) days (unless the parties hereto have mutually agreed to extend such period) then and in that event the refusal on the part of the State to accept such quitclaim shall be conclusive and binding evidence that the acceptance by the State of such quitclaim would not be in the interest of the State of California.

In the event of partial surrender, as provided, the portion of the area quitclaimed shall be in a compact form and contain ten (10) acres of multiples thereof. Such quitclaim shall expressly grant to the State and its Lessees the necessary or convenient easements or rights-of-way through, under or over the portion not quitclaimed, to prospect for, produce and take oil and gas and other products from such surrendered areas or zones; provided, however, that no easement or right-of-way is expressly granted to the State or its Lessee if such easement or right-of-way shall come within one hundred (100) feet from the perforated portion of any well or wells located in the demised premises and belonging to the Lessee who is quitclaiming.

6. In the event any well has been or is completed with any part of its producing interval within five hundred (500) feet from the exterior boundary of this Lease, and if such well is capable of producing oil and/or gas in commercially profitable quantities, then the State may notify the Lessee in writing to drill an offset well thereto, and within thirty (30) days from the date of such notice, unless the Lessee gives the notice hereinafter provided for, the Lessee shall commence operations for the drilling of an offset well on the demised premises to the same zone as that zone from which such well is producing, or is capable of producing, oil and/or gas.

Should Lessee contend the well to be offset is not capable of producing oil and/or gas in commercially profitable quantities, then Lessee shall give the State notice of such contention within ten (10) days from the notice from the State and the matter shall be submitted to arbitration as in Paragraph 5 provided. The finding made upon such arbitration as to whether the well to be offset is or is not capable of producing oil and/or gas in commercially profitable quantities shall be binding upon the parties hereto, together with their heirs, assigns, sublessees or successors in interest, and shall be made in the manner and within the time and under all the conditions as in said Paragraph 5 provided. Such determination shall not prejudice the right of the State to again renew such notice to drill from time to time upon changing circumstances occurring in respect to the well to be offset. Should it thus be found that the well to be offset is capable of producing oil and/or gas in commercially profitable quantities, then Lessee shall commence operations for said offset well within thirty (30) days from the date of such finding, but if the contrary is thus found no such obligation shall exist.

Should the State consent in writing to the assignment, transfer or subletting of this Lease, the Lessee shall continue to assume, during the terms of this Lease, or any extension thereof, jointly with any assignee, transferee or sublessee, responsibility for compliance with all of the terms, covenants, conditions, agreements, and provisions of this Lease.

7. In the event the Lessee shall fail in the performance or observance of any of the terms, covenants, and stipulations hereof, or of the rules and regulations of the State now promulgated or any reasonable rules or regulations which it may hereafter promulgate and if such default shall continue for a period of thirty (30) days after written notice thereof to the Lessee, and no steps shall have been taken within that time, in good faith, to remedy said default then the State may cancel said Lease and enter upon the demised premises and take possession of the same and all facilities, tools, equipment and supplies thereon, for the purpose of completing and/or operating said wells. Should the Lessee fail or refuse to operate the well or wells in the manner prescribed by the provisions of the Lease, then the State shall have the right and power to operate or shut down the entire operations of the Lessee upon the demised premises until such conditions have been corrected; the Lessee hereby agrees to pay all expenses incurred by the State incident to such State action. The waiver of or failure of the State to act upon any particular cause of forfeiture shall not prevent the cancellation of this Lease for any other cause or for the same cause occurring at another time.

8. The State expressly reserves the right to allow, and to continue to allow if and where presently existing, upon such terms as the State may determine, that joint or several use of such easements or rights-of-way, including easements upon, through, or in the demised premises as may be necessary or appropriate for the working of any State lands.

9. The Lessee shall use all reasonable precautions to prevent waste of oil or gas developed in the demised premises, or the entrance of water through wells drilled to the oil-bearing strata and the destruction or injury of the oil deposits.

10. The Lessee shall comply with all valid laws of the United

States and of the State of California and with all valid ordinances of cities and counties applicable to the Lessee's operations, including without limitation by reason of the specifications thereof, the Lessee's compliance with Division 3 and 6 of the Public Resources Code, Statutes of California, and such rules and regulations as are, or may be issued pursuant thereto.

11. The Lessee shall commence operations for the drilling of wells into the demised premises, and thereafter diligently continue with such drilling in accordance with the drilling program attached hereto, marked Exhibit A, and by reference made a part hereof. The drilling obligations imposed upon Lessee by the provisions of this paragraph shall be suspended during such time as the Lessee is prevented or hindered from complying therewith by wars, strikes, riots, acute and unusual labor or material shortages, acts of God, laws, rules and regulations of any federal, state or municipal agency or by such other unusual conditions as the State may determine to be beyond the control of the Lessee.

12. The Lessee shall exercise reasonable diligence in the operation of the wells while the products therefrom can be obtained in commercial quantities and shall not unreasonably or unnecessarily suspend continuous operations except with the consent of the State. All operations hereunder shall be carried on in a proper and workmanlike manner in accordance with approved methods and with due regard for the protection of the safety and health of workmen.

13. The Lessee shall be liable for and agrees to indemnify the State against any and all losses, damages, claims, demands or actions caused by, arising out of, or connected with the operations of the Lessee hereunder.

13 (a). The Lessee agrees to deliver up the premises leased, with all permanent improvements thereon, in good order and condition, upon the termination of, or forfeiture of, this lease, or to remove, at the option of the State, all derricks, buildings, piers, machinery, fixtures and

such other things as may have been put thereon by the Lessee, such removal costs to be borne by the Lessee and at no expense to the State, provided that if said option last mentioned is at any time to be exercised by the State it shall give sixty days written notice to the Lessee of its intention to exercise said option.

14. The Lessee shall, at the time of execution of this Lease, furnish and thereafter maintain a good and sufficient bond in favor of the State of California in the penal sum of \$65,000.00 to guarantee the faithful performance by the Lessee of the terms, covenants and conditions of this Lease and of the provisions of Division 6 of the Public Resources Code, Statutes of California, and of the rules and regulations promulgated thereunder.

15. The Lessee shall file with the State true and correct copies of all sales contracts for the disposition of oil, gas, natural gasoline and other substances produced hereunder. Said copies shall be certified by the Lessee to be true and correct copies of the originals. In the event the State should elect to take royalty in money instead of in kind, the Lessee shall not sell or otherwise dispose of the products produced hereunder except in accordance with such sales contracts or other method first approved in writing by the State.

16. The Lessee shall furnish correct and true monthly statements in detail in such form as may be prescribed by the State, showing with respect to each well, the amount, gravity and market price at the well of all oil produced, saved and sold, the amount and gross value of gas produced, saved, used and sold and the amount and gross value of natural gasoline or other products produced hereunder by the Lessee therefrom during the preceding calendar month, and the number of days each well is on production, as the basis for computation of royalties due the State.

17. The Lessee shall keep true, correct, full and complete records and accounts of the cost of development and the cost of production of oil, gas, natural gasoline and other products derived from the wells drilled by the Lessee into the demised premises. Such records and accounts

shall be open and available at all reasonable times to the inspection and examination of any person authorized by the State.

18. The Lessee does hereby consent to an examination of the books and records of any individual, association or corporation which has transported for, or received from the Lessee any oil, gas, natural gasoline and other products produced from the demised premises; and to the inspection at all times of the operations of the Lessee with respect to the wells, improvements, machinery and fixtures used in connection therewith by any person authorized by the State.

19. The Lessee shall make logs, including electric logs and surveys of the wells drilled by the Lessee into the demised premises in accordance with the provisions of this lease and in accordance with approved current practices of operations of this character in effect at the time it undertakes such operations, and shall promptly file copies of all such logs and surveys, drilling records and well histories, and also all records of well cores and other related information with the State Lands Commission. All data with respect to surveys and electric logs shall be made available at the time taken; to any designated employee of the Commission. The Lessee does hereby waive the statutory limitations upon the use by the State, or a duly authorized employee of the State, of any information filed with the Division of Oil and Gas of the Department of Natural Resources by the Lessee. Any and all information filed by the Lessee with the said Division of Oil and Gas shall be available at all times to the State for the purpose of enforcing compliance with the terms, covenants, and conditions of this agreement and rules and regulations now or hereafter promulgated by the State.

20. The Lessee shall furnish to the State detailed drawings of all pipe lines attached in any manner to the said wells and report

any changes or additions promptly, and shall gauge all oil, and measure all gas, whether dry or wet, in accordance with the rules and regulations now or hereafter promulgated by the State, provided, the State shall have, at all times, the right to gauge and sample all oil and measure and test all gas, gasoline and other products, and in the event of a disagreement between the State and the Lessee concerning the quality and/or quantity of the oil, gas, gasoline and/or other products so gauged or measured, the burden of establishing the incorrectness of such gauging and/or measurement shall rest upon the Lessee, and the Lessee is hereby given the right to establish, by proper court proceedings, the correct quality and/or quantity of such oil and/or gas so gauged and/or measured. The Lessee shall measure the production from each well and shall take samples and make tests of the oil produced from each well to determine the net volume thereof.

21. The State shall have the right to restrict by appropriate rules and regulations the spacing of wells and the rate of drilling and production of such wells so as to prevent the waste of oil and/or gas and to promote, without reservoir impairment, the maximum recovery of oil and gas from each zone or separate underground source of supply of oil and/or gas covered in whole or in part by this Lease. The State may issue rules and regulations which may be amended from time to time to effectuate the purpose of this paragraph, and in connection therewith restrict the rate of production from any such zone or separate underground source of supply to that provided by Federal or State laws or rules or regulations thereunder, or by any reasonable conservation or curtailment plan ordered by the State or agreed to by the producers representing a majority of the total production from any such zone or underground source of supply.

22. Each well drilled pursuant to the terms of this Lease shall

be drilled in accordance with the rules and regulations now or which may hereafter be promulgated by the State.

In the event that any well to be drilled must penetrate tide and submerged lands not leased hereunder, easement for such crossing will be granted by the State, pursuant to applicable statutes and rules and regulations, after the approval of the course and objective referred to hereinbefore.

23. All operations under this Lease shall be conducted in such a manner as to prevent pollution and contamination of the ocean and tidelands or any impairment of and interference with bathing, fishing, or navigation in the waters of the ocean or any bay or inlet thereof, and no oil, tar, residuary products of oil, or any refuse of any kind from any well or works of the Lessee shall be permitted to be deposited on or pass into the waters of the ocean or any bay or inlet thereof.

24. In the event that the Lessee at any time during the term hereof is insolvent, or makes a voluntary assignment of his assets for the benefit of creditors, or is adjudged a bankrupt, either upon Lessee's voluntary petition in bankruptcy, or upon the involuntary petition of Lessee's creditors, or any of them, or should an attachment be levied and permitted to remain for an unreasonable length of time upon or against the interest, rights or privileges of Lessee in or to any oil, gas, natural gasoline or other products produced from the wells drilled by Lessee upon the demised premises, then all of the interest, rights and privileges of Lessee in and to all oil, gas, natural gasoline or other products produced and saved from the demised premises by reason of Lessee's operations thereon, shall immediately cease, terminate and end, and in such event the State shall have, and Lessee, by the acceptance hereof, hereby gives the State the right, option and privilege to cancel and terminate this Lease and all of the terms and provisions granted hereby, and all of the rights and privileges of Lessee in and to or upon the demised premises and in and to any oil, gas, natural gasoline or other products produced and saved from the demised premises by reason of Lessee's operations thereon, and all of Lessee's rights and privileges granted by this Lease shall immediately

cease and terminate and end upon receipt of written notice from the State that the State is so exercising its option.

25. The Lessee may use for such operations of Lessee's wells in the demised premises as are necessary, oil produced from Lessee's wells upon the demised premises. Such oil shall be used for fuel purposes ONLY. The Lessee may also use for fuel purposes ONLY, gas produced from Lessee's wells upon the demised premises or gas received currently in exchange for such gas so produced. Any surplus gas produced from the Lessee's wells or received currently in exchange for such gas so produced may be used ONLY for such gas-lift operations in Lessee's wells in the demised premises as are necessary or for necessary repressuring of the oil sand or sands from which the well or wells may be producing. The State at its option shall be entitled to take, without payment of compensation therefor, but at no expense to the Lessee, all surplus gas which cannot be marketed by the Lessee at a reasonable price. Such surplus gas as may be taken by the State shall be for the use of the State of California.

26. Lessee shall be empowered to sell and convey good title to the full amount of the State's royalty share of oil, gas, natural gasoline and other products produced and saved if and when such sales have been approved in writing as herein provided. All oil, gas, gasoline or any other products produced from the demised premises shall be held by the Lessee in trust for the State until the Lessee shall have made full royalty payment to the State therefor.

27. This Lease may be terminated and any of the provisions hereof may be modified or amended, upon the mutual consent in writing of the parties hereto.

28. All notices herein provided to be given or which may be given by either party to the other shall be deemed to have been fully given when made in writing and deposited in the United States mail, registered and postage prepaid, and addressed as follows:

(To the State):

State Lands Commission,  
California State Building,  
Los Angeles 12, California

and

(To the Lessee):

Bankline Oil Company

The addresses to which the notices shall or may be mailed, as aforesaid to either party, shall or may be changed by written notice given by such party to the other as hereinabove provided; but nothing herein contained shall preclude the giving of any such notice by personal service.

29. The Lessee agrees to pay, when due, all taxes or assessments lawfully assessed and levied under the laws of any State, County, City or the United States of America, against improvements or against oil, gas and other products produced from the demised premises.

IN WITNESS WHEREOF, The parties hereto have executed this Lease effective the date and year first above written:

STATE LANDS COMMISSION of  
the STATE OF CALIFORNIA

By *Rufus W. Johnson*  
Executive Officer.

Date *October 22, 1949*

LESSEE:

BANKLINE OIL COMPANY

By: *R. L. Herbert*  
President

And: *R. C. Chivers*  
Assistant Secretary

ATTEST:

EXHIBIT "A"

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1. The failure of the State to enforce any of the conditions or requirements of this exhibit shall not constitute a waiver by the State of such conditions or requirements.

2. The term "operations" as used herein is hereby defined to be the actual penetration of the ground with a drilling bit.

3. Any offset well drilled in accordance with the provisions of this exhibit shall be drilled from such surface location as specified by Section 6873 of the Public Resources Code and to such bottom hole location as shall be determined by the Commission.

4. For general purposes, an oil and/or gas zone is hereby defined to mean any sequence of strata containing oil, gas or other hydrocarbon products whenever such sequence of strata lies immediately below a layer of shale or other impervious rock; provided such layer of shale or other impervious rock has a minimum thickness of at least fifty (50) feet.

5. In drilling all wells to any zone or zones, electric logs shall be made of all formations penetrated and rock core samples shall be taken in order to identify all of the geological formations and to determine the productive possibilities of all oil and/or gas zones penetrated by the well. At least one oriented core or dip-meter record shall be made during the drilling of the first well to each zone. Copies of all electric logs, surveys, paleontological reports, dip-meter records, core records, oriented core records and all other drilling data shall be immediately available to the representatives of the State, and said representatives shall also have ready access to all cores and samples which may be obtained during the drilling of each well.

6. Within forty-five (45) days after the completion of any well or

wells drilled into the leased premises from any upland drill site area, or the diligent prosecution to abandonment of any well or wells found to be unproductive, the Lessee shall remove from the drill site area all derricks and surface equipment or other drilling facilities. The Commission at the time of award of this Lease may require that Lessee observe any other reasonable condition which the Commission might at the time of such award impose, and any such condition or conditions shall from the time of acceptance of this Lease by Lessee be thenceforth binding upon Lessee.

EXHIBIT "B"

The oil royalty which the Lessee shall pay to the State shall be according to the following formula:

$$R = \frac{P}{2.5} \div \frac{36.67}{.016667P}$$

Where R is the royalty rate in per cent applicable to the total value of the production of oil during the month, P is the average daily production of oil per well per zone of the lease determined by dividing the total oil production for the month by the total number of production days of twenty-four hours each for the total wells in each zone.

For the purpose of computing royalties hereunder, the State and the Lessee hereby mutually agree that all oil production from presently producing zones shall be considered as production from one zone, and any new wells drilled into these zones shall be considered as producing from the same zone.

provided, however, the Lessee shall pay at all times a minimum royalty of twelve and one-half (12 1/2) per cent upon such average daily production.

APPLICATION:

1. The value of production shall be determined as the value at posted price of the net barrels and quality of marketable oil produced from the lease during the calendar month.

2. The production for the lease shall be determined from the measurement of stocks of marketable oil on hand at the beginning of the month, shipments during the month and stocks of marketable oil on hand at the end of the month.

3. Stocks on hand are to be gauged as of 7:00 A.M. of the first day of each month or such other time as the parties hereto may agree upon in writing.

4. Marketable oil is defined for the purposes of this lease as containing 3.0% or less B.S. & W.