WEXPRO COMPANY
79 SOUTH STATE STREET • P.O. BOX 11070 • SALT LAKE CITY, UTAH 84147 • PHONE (801) 530-2700

R. M. KIRSCH
PRESIDENT

May 7, 1986

Mr. Bob Lake
Price Waterhouse
50 West Broadway, Suite 800
Salt Lake City, UT 84101

Mr. Douglas Ball
Ball Associates, Ltd.
105 Main Street
P. O. Box 8
Black Hawk, CO 80422

Gentlemen:

RE: Wexpro Agreement - Accounting for Pre-July 31, 1981, Overriding Royalty Interests - and Nonstatus Wells

Wexpro Company respectfully requests Wexpro Agreement monitor approval of the enclosed proposed accounting guidelines for pre-July 31, 1981, overriding royalties which were owned by Wexpro or Mountain Fuel at the time of execution of the Wexpro Agreement. This letter has two component parts: Part I is a list of the guidelines which will be distributed to the accounting and operating personnel and Part II is a discussion of the Wexpro Agreement provisions and rationale for this request. To avoid the need to flip back and forth from this letter to the Wexpro Agreement, we have several times quoted from the same sections of the Agreement. All references are to the Wexpro Agreement unless otherwise noted.

I. PROPOSED GUIDELINES

1. Productive Gas Reservoirs. If an overriding royalty is attributable to production from a well completed into a Productive Gas Reservoir (as defined in Section I-25), the portion of the production attributable to an account 101/105 or transferred lease will be owned by Wexpro, Wexpro will receive all proceeds and will pay 100 percent of such proceeds to Mountain Fuel.

2. Nonstatus Gas Wells. Those include pre-July 31, 1981 farmout wells in which there were no capitalized drilling nor equipment costs on Mountain Fuel's books on that date and which were completed into productive gas reservoirs. Solely for the purposes of sharing production and for future investments in the well (but not for determining development drilling areas), these wells will be classified as "prior Company-nonstatus." Thus, future investments in these wells will be treated as "Post-July 1981, Investments" under Section III-4. Revenues will be handled in accordance with guideline 1 above.

3. Productive Oil Reservoirs. If an overriding royalty is attributable to production from a well completed into a Productive Oil Reservoir (as defined in Section I-24), the portion of the production attributable to the 101/105 or transferred lease would be subject to the 54-46 formula as described in Sections II-3 and II-4.

4. Nonstatus Oil Wells. Those oil wells completed into Productive Oil Reservoirs which did not have any capitalized drilling nor equipment costs on Wexpro's books on July 31, 1981, will be classified as "prior Wexpro well-nonstatus." Revenues will be shared and investments incurred according to guideline 3 above. These wells will not be used for determining development drilling areas.

5. Exploratory Properties and Article V Properties. Exploratory properties are defined in Section I-29 as any formation underlying an account 101/105 or transferred leasehold into which exploratory drilling is conducted. Thus, as a catchall, exploratory drilling includes every kind of drilling that is not considered development oil or development gas drilling as defined in Sections I-27 and I-28. If the overriding royalty interest is attributable to production from any formation or part of a formation which is an exploratory property, and the lease is listed on either of Schedules 4(a) or 4(b), then there will be a 7 percent override payable to Mountain Fuel on the proceeds of the base override.

Likewise, Mountain Fuel will be entitled to receive a 2½ percent overriding royalty if the override is associated with a lease listed on Schedule 5. See Section V-3.

In both of these instances, Mountain Fuel would be receiving a 7 percent or 2½ percent overriding royalty on the Wexpro/Celsius override. E.g. 7 percent of a 5 percent retained override under a farmout equals a 0.35% net royalty interest. The well would be classified as either "Celsius 7%" (CE-7) or "Celsius 2½%" (C-2½%) and will be treated as any other exploratory drilling. Future investments, if any, will be made entirely by Celsius. Upon conversion of a farmout backin option, the Company will receive either 7% or 2½% of Celsius' gross working interest after such conversion.

The only exceptions to rule 5 are the wholly owned Wexpro/Celsius overrides including but not limited to the North Walker Creek, Walker Creek, and Wright (Hilight) areas of Wyoming.

6. Overriding Royalty Matrix. The following matrix may be of assistance in resolving future classifications of overrides.

Wells Completed Before August 1, 1981	101 Lease Sch. 4(a)	105 Lease Sch. 4(b)	Transferred Lease	Stipulation Lease Sch. 5
Well completed within productive gas reservoir's development drilling area	100% of ORR to MFS ¶III-2(a)	100% of ORR to MFS ¶III-2(a) & §IV-3	N/A	2½% of ORR to MFS §V-3
Well completed within productive oil reservoir's development drilling area	54-46 formula sharing §II-4	54-46 formula sharing §II-4	54-46 formula sharing §II-4	2½% of ORR to MFS §V-3
Well completed outside productive oil or productive gas reservoir's development drilling area	7% of ORR to MFS §§IV-2 & IV-4	7% of ORR to MFS §§IV-2 & IV-4	7% of ORR to MFS §§IV-2 & IV-4	2½% of ORR to MFS §V-3

II. DISCUSSION

1. Overview.

Overriding royalties, also known as overrides, are defined in Section I-35 as "[a] royalty interest in oil and gas and other minerals produced at the wellhead in addition to the usual landowner's royalty reserved to the lessor."(Emphasis added.) The term "royalty" as used in Section I-35 is further defined in Section I-34 as follows:

> I-34. Royalty. Generally, a percentage of the gross revenues generated from production from a lease. The royalty owner or recipient remains legally responsible for his pro rata share of handling and transportation costs (if taken in kind) and production-related taxes, including but not limited to severance, ad valorem, and windfall-profits taxes. For those leases from which production is owned only in part by the Company or Wexpro as of July 31, 1981, a royalty provided for in this agreement will apply only to production attributable to the company's or Wexpro's respective net interest, as the case may be.

(The term "Company" as used herein is also synonymous with Mountain Fuel Supply Company or Mountain Fuel. See Section I-1.)

Support for this treatment can be found in the preamble to "Article I - Definitions" found on page 2 of the Wexpro Agreement where it is stated, "For the purposes of this Agreement, and the Stipulations to which it is attached, the following definitions will apply to the indicated terms wherever they appear."

Thus, the use of the word "royalty" in Sections I-34 and II-4 includes overrides.

There are two types of overriding royalties contemplated by the Wexpro Agreement. The first type covers the 7 percent and the 2½ percent overrides provided for in Sections IV-4 and V-3 respectively. These overrides are carved out of the account 101/105, transferred and Article 5 leases now owned by Wexpro/Celsius. There is no guideline nor clarification needed on treatment of these overrides required here.

These guidelines and the discussion herein refer to a second type of override. This second type covers those which were owned by the Company/Wexpro on July 31, 1981 and which were reserved in assignments or agreements with third party working interest owners. For example, if Wexpro/Mountain Fuel assigned all of its working interest to Amoco but reserved a 4% override we would say that the Wexpro's 4% override was carved out of the Amoco 100% working interest. Generally, these overrides can be described as naked overrides, farmout overrides and other types such as production payments and net profits interest.

The naked override is owned separately from any working interest or back-in farmout conversion option. It typically has a duration for the life of the leasehold working interest from which it was carved. Usually it is associated with an interest in specifically described lands but occasionally may be attributable solely to production from one or more wells.

A farmout type of override is created by a specific farmout agreement. Generally it is a component part of a payout option clause which provides an option to the farmor to convert all or a portion of the override to a working interest when the farmout well has reached payout (i.e. the break-even point). The farmout override is typically applicable to production from wells but occasionally will be attributable to all lands subject to and within the drill site spacing unit for the farmout well.

The third type of override including production payments and net profits interests, are very rarely encountered by Wexpro and the Company.

2. Nonstatus Wells.

The discussion about and specific treatment of overrides would be incomplete without an introductory discussion of nonstatus wells. When the Wexpro Agreement was executed, the parties listed all wells which had capi-

talized drilling and/or equipment costs on the Company's or Wexpro's books. These wells are listed on Schedules 2(b) and 3(b). If the equipment and drilling costs were capitalized on Mountain Fuel's books, the well was classified as a "Prior Company Well," or stated another way, as a gas well. Similarly, if such costs were capitalized on Wexpro's books, the well was an oil well and labeled a "Prior Wexpro Well."

However, the Company and Wexpro have interests in wells in which there were no capitalized drilling and/or equipment costs on either Wexpro's or Mountain Fuel's books. Therefore, there were no utility customer dollars involved in the drilling, testing, equipping or completing of the wells. Typically, nonstatus wells had no capitalized costs because they are "farmed out" to third parties who would pay 100 percent of the drilling and equipment costs for the right to earn an interest in the account 101/105 or transferred leases. Solely for the purposes of sharing production and for future investments in the well (but not for determining development drilling areas), the well will be classified as "prior Company-nonstatus" or "prior Wexpro-nonstatus."

3. Division of Properties.

The discussion of overrides would also be incomplete without discussing the ownership of oil, gas and natural gas liquids in Productive Gas Reservoirs. All of the account 101 leaseholds have been transferred to Wexpro under Paragraph III-2(a) and Section IV-1. In addition, all account 105 leases have been transferred to Wexpro under Section IV-2. To the extent the oil, gas and natural gas liquids are produced from a prior company well or development drilling into productive gas reservoir and are attributable to an account 101 leasehold, such production is owned by Mountain Fuel under Paragraph III-2(a). If similar production is from an account 105 lease and is attributable to a productive gas reservoir, it is owned by Mountain Fuel under Section IV-3.

Transferred leases associated with oil wells had previously been assigned from Mountain Fuel to Wexpro prior to July 31, 1981. The Wexpro Agreement left those leases with Wexpro with the production proceeds to be subject to the 54-46 formula, after expenses. See Article II.

All production from account 101, account 105 and transferred leases which is not attributable to prior Company wells, prior Wexpro wells, or development oil or gas drilling becomes exploratory property production under Sections I-29, IV-2 and IV-4.

4. Productive Gas Reservoir Overriding Royalties.

The Wexpro Agreement in Article III discusses the treatment of account 101 leaseholds. It is clear from the Wexpro Agreement that when an override is attributable to a Prior Company Well completed into a Productive Gas

Reservoir, the portion attributable to an account 101 leasehold will be received by Wexpro and such proceeds will be accounted for to Mountain Fuel.

The override is owned by Wexpro under paragraph III-2(a) of the Wexpro Agreement which states:

> (a) The Company will transfer to Wexpro all 101/105 Account leaseholds and operating rights held by the Company and accounted for in its 101 Account on July 31, 1981, such transfer to be subject to a retention by the Company of the ownership of oil, natural gas liquids and natural gas and other minerals produced from productive gas reservoirs underlying such leaseholds.

The Wexpro Agreement also required that there would be a "[r]eduction of utility rate base by removal of all leaseholds from rate base accounts, thereby reducing utility revenue requirements." (Emphasis added.) See Wexpro Stipulation, Section 3.3.11. Although the override is owned by Wexpro, 100 percent of the proceeds of the override attributable to productive gas reservoirs will be accounted for in the utility accounts.

If the override is from a nonstatus well producing from a productive gas reservoir, the override is owned by Wexpro, the proceeds are likewise received by Wexpro and such proceeds are accounted for to Mountain Fuel. At such time as the nonstatus wells reach payout and assuming the override is terminated or reduced by a back-in conversion option and converted all or in part to a working interest, the working interest will also be owned by Wexpro but the proceeds will be accounted 100 percent to Mountain Fuel. Any future investments in the well after such conversion will be covered by Section III-4 of the Wexpro Agreement as "Post-July 1981 Facilities."

The rationale for the ownership of such nonstatus overrides and subsequent accounting to Mountain Fuel for 100 percent of the proceeds thereof can be seen by reading Section I-12 and by a slightly different reading of paragraph III-2(a). The definition of account 101/105 leaseholds in Section I-12 includes overriding royalty interests. Section I-12 reads as follows:

> I-12. Account 101/105 leaseholds. All leasehold, operating rights, working interests, mineral and other interests in production which were held on July 31, 1981, by the Company and which were accounted for on that date in the Company's Accounts 101 or 105. (Emphasis added.)

The Company has historically classified overrides as "mineral or other interests." If we reinterpret paragraph III-2(a) by replacing the term "leaseholds and operating rights" with its subcomponent "overriding royalty," it would more clearly address overrides as follows:

> (a) The Company will transfer to Wexpro all 101/105 Account [overriding royalties] held by the Company and accounted for in its 101 Account on July 31, 1981, such transfer to be subject to a retention by the Company of the ownership of oil, natural gas liquids, natural gas and other minerals produced from productive gas reservoirs underlying such [overriding royalties].

Therefore, if the override or other interests are attributable to productive gas reservoirs, the revenue is received by Wexpro and paid to Mountain Fuel under paragraph III-2(a).

If the override were accounted for in the 105 account on July 31, 1981, and the revenue is attributable to a productive gas reservoir, the revenue is likewise received by Wexpro and accounted for 100 percent to Mountain Fuel under Section IV-3. That section states:

> IV-3. Account 105 productive gas reservoirs. Any productive gas reservoir underlying Account 105 leaseholds transferred under this Article and listed on Schedule 3(a) is subject to a retention by the Company of the ownership of oil, natural gas liquids, natural gas and other minerals produced from such reservoirs.

5. Productive Oil Reservoir Overriding Royalty Interests.

Prior to the Wexpro Agreement, the Company had transferred to Wexpro all productive oil properties and wells. (For the purposes of this discussion, oil and natural gas liquids will sometimes be referred to as "oil." Casinghead natural gas will sometimes be referred to as "gas.")

The transferred properties are defined as "transferred leaseholds" under the Wexpro Agreement. Section I-13 provides this definition:

> I-13. Transferred leaseholds. All leaseholds, operating rights, working interests, mineral and other interests in production which were held by Wexpro on July 31, 1981, and which had previously been accounted for in the Company's 101 or 105 Accounts immediately prior to transfer, but excluding leasehold or production rights acquired by farmout from the Company.

Since Wexpro already owned the oil properties, the Wexpro Agreement recognized this fact and left title with Wexpro under Section II-2. The Wexpro Agreement lists the productive oil reservoirs on Schedule 2(a) and prior Wexpro wells on Schedule 2(b). See Section II-1. Section II-2 specifically addresses oil properties and wells:

> II-2. Title and operation. Any right, title and interest to the properties described on schedules 2(a) and 2(b) and the corresponding leases, operating rights, wells and appurtenant facilities held by Wexpro will be and remain the sole and exclusive property of Wexpro and will be held and operated by Wexpro in accordance with the terms and conditions of this Article II. Oil, natural gas, and natural gas liquids from productive oil reservoirs will be developed and produced by Wexpro in a prudent manner in accordance with accepted industry standards.

All production from productive oil reservoirs is also owned and controlled by Wexpro. Section II-3 reads:

> II-3. Ownership of oil, natural gas liquids and natural gas. All oil, natural gas liquids and natural gas produced from productive oil reservoirs will be the property of and be sold or otherwise disposed of by Wexpro.

Therefore, from an examination of the Wexpro Agreement, the oil, natural gas liquids and casinghead gas from productive oil reservoirs are clearly owned by Wexpro. Mountain Fuel has a continuing interest in that production pursuant to Article II and the gross proceeds therefrom will be shared by Wexpro with Mountain Fuel according to the 54-46 formula.

6. Exploratory Property Overrides.

"Exploratory properties" are defined in Sections IV-2 and I-29 of the Wexpro Agreement as formations underlying account 101/105 or transferred leaseholds which do not qualify as Productive Gas or Oil Reservoirs as defined in Sections I-24 and I-25. Thus, as a catchall, exploratory properties includes leasehold and operating rights to all formations which are not classified as Productive Oil and Gas Reservoirs. All drilling which is not classified as Development Oil or Development Gas is classified as Exploratory. Sections IV-2 and I-29 read as follows:

> IV-2. Transfer of Account 105 Leaseholds. All Leaseholds and operating rights held by the Company in Account 105 on July 31, 1981 will be transferred to Wexpro, effective August 1, 1981, subject to the conditions set forth elsewhere in this Article IV. All exploratory properties, as defined in section I-29, that are associated with the 101/105 leaseholds held in the Company Account 101 on July 31, 1981, are to be transferred to Wexpro under Article III, but will be subject to the terms of this Article IV.

> I-29. Exploratory Drilling. Any drilling after July 31, 1981, for the purpose of locating or producing hydrocarbons that is not development oil or gas drilling. Formations underlying Account 101/105 leaseholds or transferred leaseholds into which exploratory drilling is conducted will be referred to as "exploratory properties."

The terms of Section IV-4 concerning the treatment of revenues from exploratory properties in part provides:

> There is hereby retained by the Company a 7% of 8/8ths overriding royalty on all natural gas, natural gas liquids and oil produced from exploratory properties as defined in Section I-29, subject to the following provisions: [Proportionate Reduction Clause]

As an example of how an override on exploratory properties would be treated, we can examine the naked overriding royalty interest in gas production associated with a lease in the Tablerock area of Wyoming. Because it was a "mineral or other interest" arising out of the leaseholds held by the Company and accounted for in its 101 account, the gas royalty was transferred to Wexpro under the Wexpro Agreement and Mountain Fuel is entitled to 7 percent of all revenues Wexpro may receive as overriding royalties on this lease.

The facts surrounding the Tablerock lease are fairly straightforward. In 1953 a Mountain Fuel employee acquired an interest in a Tablerock, Wyoming, federal oil and gas lease. He entered into an option agreement with Mountain Fuel which granted to the Company the right to explore and an option to buy the lease. By 1960 the Company had exercised its option to acquire the lease and had subsequently assigned its interest to Scimitar Oil (and subsequently other companies including Houston Oil & Gas Minerals Corporation, the present operator) subject to a reserved overriding royalty of 7-1/8 percent in gas and 4-1/8 percent in oil in favor of Mountain Fuel.

In 1962 the company's interest in the Tablerock lease was categorized as a productive property by the company's land department. This was based on information received from the Bureau of Land Management confirming U. S. Geological Survey information which had determined the lease to have actual production. From the time the Tablerock lease was categorized as "productive," the override has been accounted for in the company's 101 account. However, the Company has no capitalized drilling and equipment costs associated with this lease. No prior wells exist and therefore no productive reservoirs exist as defined in Section I-24 or I-25.

In Section I-28 development gas drilling is defined. It is limited to drilling completed after July 31, 1981, and drilled within a development

drilling area associated with a productive gas reservoir or prior Company well. Because the wells on the Tablerock lease were completed prior to July 31, 1981, and because there are no productive gas reservoirs nor prior Company wells associated with the lease, the entire area and all formations underlying the override fall within the category of exploratory properties.

Under the Wexpro Agreement, the mineral interest held by the Company in the Tablerock lease was listed on Schedule 4(a) which lists the company's Account 101 leasehold interests. The actual listing for the lease includes Wyoming Tablerock leases designated as Nos. 29M and 29AM. The Tablerock lease does not include a prior Company well nor a productive gas reservoir as defined in the Wexpro Agreement nor listed on Schedules 3(a) or 3(b) of the Wexpro Agreement. Wells completed on the Tablerock lease including the Bowen No. 1 Well completed in 1962 and the Federal 12X-14b Well completed in June 1981 and are wells which have been drilled and equipped by other companies since Mountain Fuel sold its working interest in the lease subject to the reserved overrides.

Turning now to classification of the Tablerock override. As previously discussed, paragraph III-2(a) explains that account 101 leases are transferred to Wexpro. The override is included as a 101/105 Account leasehold "mineral and other interests" under Section I-12. Thus, the Tablerock lease override would have been transferred to Wexpro under the Wexpro Agreement.

An examination of the definition of exploratory properties under the terms of the Wexpro Agreement shows that the Tablerock lease falls under this category. The definition of exploratory properties is found in Section I-29 of the Wexpro Agreement which defines exploratory drilling. That section again provides:

> I-29. Exploratory drilling. Any drilling after July 31, 1981, for the purpose of locating or producing hydrocarbons that is not development oil or gas drilling. Formations underlying Account 101/105 leaseholds or transferred leaseholds into which exploratory drilling is conducted will be referred to as "exploratory properties."

The treatment of account 101 exploratory properties is specifically addressed under Section IV-2 of the Wexpro Agreement. That section in part provides:

> All leaseholds and operating rights held by the Company in Account 105 on July 31, 1981, will be transferred to Wexpro, effective August 1, 1981, subject to the conditions set forth elsewhere in this Article IV. All exploratory properties, as defined in section I-29, that

> are associated with the 101/105 leaseholds held in the Company Account 101 on July 31, 1981, are to be transferred to Wexpro under Article III, but will be subject to the terms of this Article IV. (Emphasis added)

The terms of Section IV-4 concerning the treatment of revenues from exploratory properties in part provides:

> There is hereby retained by the Company a 7 percent of 8/8ths overriding royalty on all natural gas, natural gas liquids and oil produced from the exploratory properties, as defined in Section I-28, subject to the following provisions:
>
> (a) In the event that on July 31, 1981, (i) the operating and working interest of the Company in the properties to be transferred and assigned is less than the full operating and working interest in the lease, or (ii) the lease covers less than the full oil and natural gas mineral estate under the lands covered by the lease, then the overriding royalty interest of the Company will be proportionately reduced and therefore the 7 percent will apply only to the interest of the Company or Wexpro on July 31, 1981.

The provisions of paragraph IV-4(a)(i) have been met because the Company owned less than the full operating and working interest in the Tablerock lease. The 7 percent of 8/8ths overriding royalty interest reserved to the Company under Section IV-4 is therefore proportionately reduced, and the 7 percent only applies against the interest the Company had on July 31, 1981. See Wexpro Agreement, Section IV-4(a). Thus, 7 percent of the revenues received by Wexpro from the 7-1/8 percent overriding gas royalty and the 4-1/8 percent overriding oil royalty should be paid to the Company. This is how the revenues from the Tablerock lease override have been accounted for by Wexpro.

7. Well Classification - Nonstatus Wells.

Once a well is classified as a "prior Wexpro well" or "prior Company well" it is then used to determine the productive oil or gas reservoir. A certain area of that reservoir is determined to be the development drilling area depending upon the areal extent of the 101/105 or transferred lease and whether the well was associated on July 31, 1981 with a spaced area, federal unit, or wildcat area. See Section I-26. In addition, the development drilling area includes a 1,980 foot cylinder drawn around the well and extending vertically from the surfact to total depth. Any future drilling into the development drilling area or into the 1,980 foot cylinder would be considered as development oil or development gas, as the case may be.

All prior Company and prior Wexpro wells are listed on Schedules 2(b) and 3(b). However, the nonstatus wells are not listed on either schedule. As such, the nonstatus wells are not used for determining development drilling areas under Section I-26.

8. Conclusion.

We believe the above proposed accounting treatment and guidelines for overrides are reasonable and in accordance with the Wexpro Agreement. We respectfully request your early concurrence.

Very truly yours,

R. M. Kirsch, President and
Chief Executive Officer

ACCEPTED:

Price Waterhouse Date

Douglas Ball & Associates Date

DIVISION OF PUBLIC UTILITIES
STATE OF UTAH

By _____
Date

cc: R. J. Gill, Jr.
M. A. Howerton
J. W. King

All prior Company and prior Wexpro wells are listed on Schedules 2(b) and 3(b). However, the nonstatus wells are not listed on either schedule. As such, the nonstatus wells are not used for determining development drilling areas under Section I-26.

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R. M. Kirsch, President and
Chief Executive Officer

ACCEPTED:

Price Waterhouse 7-9-86
Price Waterhouse Date

Douglas Ball & Associates Date

DIVISION OF PUBLIC UTILITIES
STATE OF UTAH

By _____
Date

cc: R. J. Gill, Jr.
M. A. Howerton
J. W. King

Re: Wexpro Agreement - Accounting for Pre-July 31, 1981, Overriding Royalty Interests - and Nonstatus Wells

APPROVED this _____ day of _____, 1985.

BALL ASSOCIATES, LTD.

By _____
Date _____

PRICE WATERHOUSE

By _____
Date _____

UTAH DIVISION OF PUBLIC UTILITIES

By _____
Date _____

STAFF OF WYOMING PUBLIC SERVICE COMMISSION

By _____
Date _____