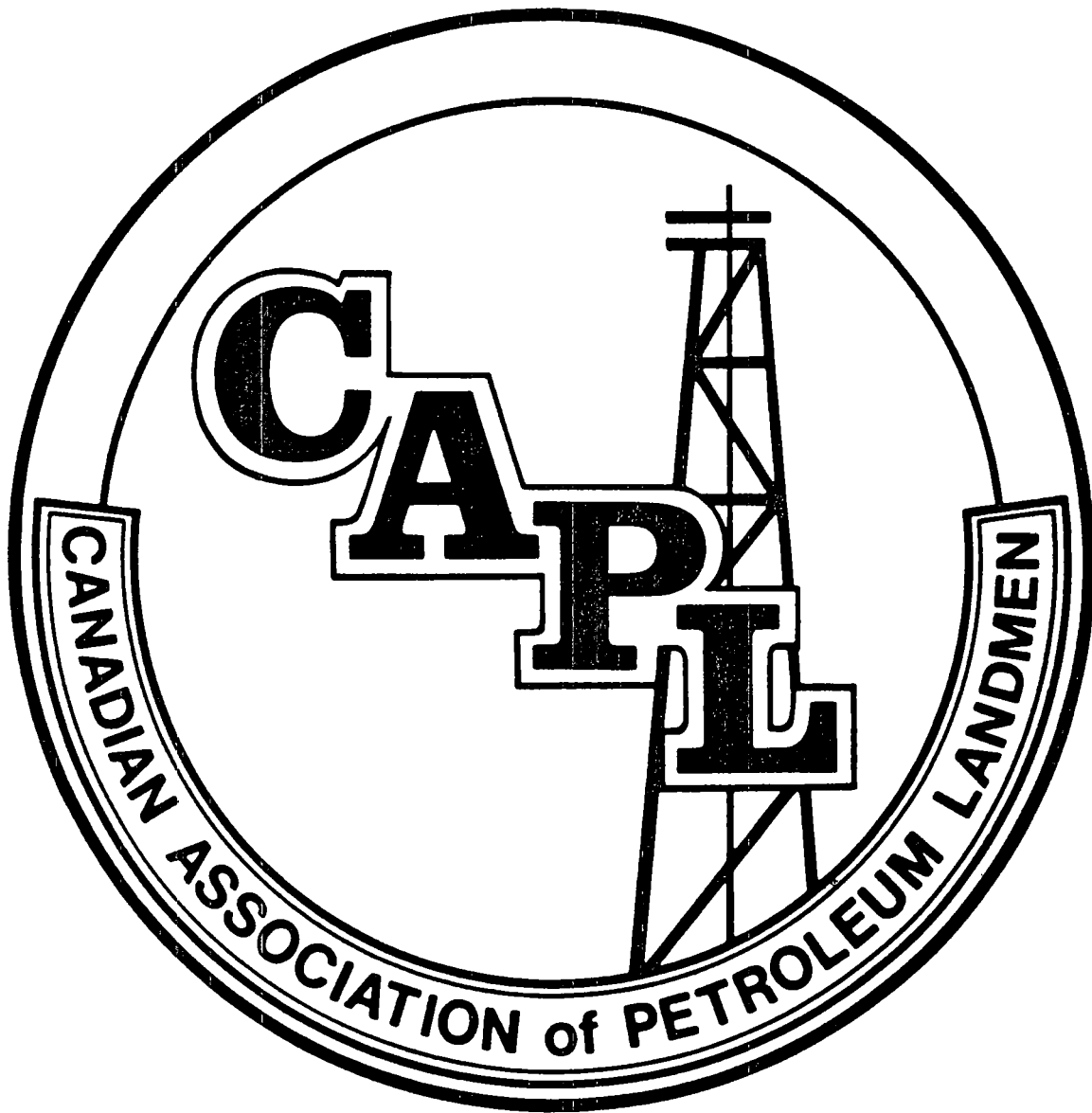


FARMOUT PROCEDURE

(Annotated)



CANADIAN ASSOCIATION OF PETROLEUM LANDMEN

Version 1.0

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FARMOUT PROCEDURE

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* Only one alternate for Article VII would apply to a particular Farmout Procedure
** Optional Clauses

Farmout Procedure

The explanatory notes reflect the observations of the authors and other commentators on the intention and scope of the provisions of the Farmout Procedure. They have been included only to assist the user in understanding the document, and are not intended to have any legal effect on the interpretation of the provisions of the document.

General The goals sought to be attained by this precedent form Farmout Procedure are

- 1 to provide as much commonality as practicable for the less controversial items of a normal farmout and
- 2 to complement certain aspects of the Agreement specifically earning requirements and conversion

With regard to the first goal it is recognized that particular deals will require modifications of certain terms but it was felt that the provisions and options provided in this procedure would be adequate for the type of agreement envisioned in the Agreement and certain variations thereof

With regard to the second goal the Clauses concerning titles information substitute wells insurance Abandonment and audit are the more prominent provisions governing the Test Well

This procedure is intended to apply only to the earning phase of the agreement insofar as possible The most obvious exceptions would be the audit clause (since it must apply to the Farmor's conversion) and the confidential information clause

Note In these comments all references to Operating Procedure means the 1990 CAPL Operating Procedure unless otherwise indicated

Heading The Farmout Procedure must be attached to a head agreement This procedure is less stand alone than the Royalty Procedure or the Operating Procedure The head agreement provides the terms of earning (including conversion) and the terms of any area of mutual interest

Article I To the extent feasible the definition and interpretation provisions of the Operating Procedure were repeated here

Subclause 1 01(a) Note the reference to access roads in Line 2 which reference is not found in the Operating Procedure

Subclause 1 01(e)

- (i) For gas wells Capping could occur before or after production testing See Clause 2 03 of the Agreement
- (ii) Capping is sufficient to earn (conditionally) pursuant to Clause 3 01 of the Agreement

Subclause 1 01 (k)

- (i) The most likely form of encumbrance would be royalties owed by one or more of the Farmor Parties
- (ii) Any Gas Purchase Contracts affecting the Farmout Lands should be described in Schedule A under Encumbrances

Subclause 1 01 (l) This definition is derived from the Operating Procedure definitions for equipping and production facility

Subclause 1 01 (n) The Agreement is set up with the Farmout Lands being the first earning block with the potential for the Option Lands being the second earning block Clause 4 02 of the Agreement ensures the provisions for the Farmout Lands apply to the Option Lands

FARMOUT PROCEDURE

Attached to and forming part of the Agreement dated the _____ of _____ A.D.,
BETWEEN/AMONG

I DEFINITIONS AND INTERPRETATION

1.01 Definitions

In this Farmout Procedure the definitions of Farmee, Farmor and Contract Depth in the Agreement are incorporated by reference herein and the following words and phrases shall have the following meanings, namely:

- (a) **Abandonment** means the proper plugging and abandoning of a well in compliance with the Regulations and the restoration of the well site and access roads to the satisfaction of any governmental body having jurisdiction with respect thereto and to the reasonable satisfaction of the owner or occupier of the surface.
- (b) **Accounting Procedure** means the Schedule entitled Accounting Procedure attached and made a part of the Operating Procedure.
- (c) **Affiliate** means with respect to the relationship between corporations, that one of them is controlled by the other or that both of them are controlled by the same persons, corporation or body politic; and for this purpose a corporation shall be deemed to be controlled by those persons, corporations or bodies politic who own or effectively control other than by way of security only sufficient voting shares of the corporation (whether directly through the ownership of shares of the corporation or indirectly through the ownership of shares of another corporation which owns shares of the corporation) to elect the majority of its board of directors, provided that a partnership which is a Party and which is comprised solely of corporations which are Affiliates as described above shall be deemed to be an Affiliate of each such corporation and its other Affiliates.
- (d) **Agreement** means the agreement to which this Farmout Procedure is attached.
- (e) **Cap** means for a well from which a Party reasonably anticipates being able to obtain production of Petroleum Substances in Paying Quantities from a zone contained in the Farmout Lands, the installation of such casing, plugs and equipment for that well as are necessary to enable that well to be Completed at a later date.
- (f) **Capping Costs** means the costs to Cap a well.
- (g) **Completion** means the installation in, on or with respect to a well of all such production casing, tubing and wellhead equipment and all such other equipment and material necessary for the

permanent preparation of the well for the taking of Petroleum Substances therefrom up to and including the outlet valve on the wellhead and includes as necessary the perforating, stimulating treating fracturing and swabbing of the well and the conduct of such production tests with respect to such well as are reasonably required to establish the initial producibility of the well

- (h) **"Completion Costs** means the costs to Complete a well
- (i) **"Drilling Costs** means all moneys expended (exclusive of Completion Costs and Equipping Costs) with respect to the drilling of a well and if applicable a substitute well under Article V (SUBSTITUTE WELL) including without restricting the generality of the foregoing, the cost of obtaining surface access to and for the site of the well the preparation of the site of such well the construction of such roadways as are reasonably necessary to gain access to the site of the well the installation of all surface and intermediate casing respecting the well the logging, coring and testing of the well and in the event the well is not Capped or Completed but is Abandoned the cost of such Abandonment.
- (j) **"Effective Date** means _____
- (k) **"Encumbrances** means those charges acknowledged by the Farmor and the Farmee against either or both the Farmout Lands and the Option Lands described as "Encumbrances in Schedule A of the Agreement
- (l) **"Equipping** means the installation of such equipment as is required to produce Petroleum Substances from a Completed well including without restricting the generality of the foregoing a pump (or other artificial lift equipment) the installation of the flow lines and production tankage serving the well and if necessary a heater dehydrator or other wellsite facility for the initial treatment of Petroleum Substances produced from the well to prepare such production for transportation to market but specifically excludes any facility serving (or intended to serve) more than one (1) well (including without restricting the generality of the foregoing any battery separator compressor station gas processing plant gathering system pipeline production storage facility or warehouse) and all real and personal property of every kind nature and description directly associated therewith excluding Petroleum Substances and the Farmout Lands
- (m) **"Equipping Costs** means the costs to Equip a well
- (n) **"Farmout Lands** means the Title Documents subject to the Encumbrances for all or the designated geological zones beneath the lands described as Farmout Lands in Schedule A of the Agreement or so much of those lands as from time to time remain subject to the Agreement
- (o) **Operating Costs** means all moneys expended (exclusive of Drilling Costs, Capping Costs Completion Costs and Equipping Costs) to operate a well for the recovery of Petroleum Substances as more particularly set forth in the Accounting Procedure
- (p) **Operating Procedure** means the Schedule if any attached to the Agreement entitled Operating Procedure
- (q) **Option Lands** means the Title Documents subject to the Encumbrances for all or the designated geological zones beneath the lands described as Option Lands in Schedule A of the Agreement or so much of those lands as from time to time remain subject to the Agreement.
- (r) **Option Well** means the well which the Farmee may drill under Article IV (OPTION WELL) of the Agreement.
- (s) **Overriding Royalty"** means that interest in the Petroleum Substances which may be reserved to the Farmor under the Agreement and as described in detail in the Royalty Procedure
- (t) **"Party"** means a person corporation or body politic bound by the Agreement and this Farmout Procedure

Subclause 1 01 (v)

- (i) Payout is a date when the Farmee recovers its costs to that date for all operations relating to that well. Payout is the last day of a period of time during which the Farmee has the right to what is in many cases 100% of the Working Interest share of the production of Petroleum Substances and during which the Farmor is entitled to receive a Farmor's Overriding Royalty.
- (ii) The cash value of Overriding Royalty delivered in kind is included at the beginning and subsequently deducted in Paragraph (iv). This is to ease accounting administration.
- (iii) As Payout is the period in which the Farmor recovers its costs, cash incentives are deducted in Paragraph (i) because such incentives reduce the cost base for the Test Well. It is not a means whereby the Farmor shares in the incentive. Paragraph (iv) allows the deduction of payments of lessor royalty. If the incentive takes the form of reduced royalty rather than a cash payment, that incentive will be reflected here since the royalty payments are reduced.
- (iv) Paragraph (iii) of the definition is derived from Paragraph 1021(d) and Clauses 1404 and 1409 of the Operating Procedure. This definition avoids the particular details of using a formula such as the Jumping Pound Formula or JP 90 and any difficulties of negotiating those details. This is accomplished by permitting the Farmee to charge the Payout account a fee the Farmee would have been charged if it were not an owner of facilities used by the Farmee and in which the Farmee has or may have an ownership.

Why include this sort of deduction? Under Paragraph (ii) a Farmor can deduct processing fees paid to third parties which fees would probably incorporate JP 90 principles. To deny a Farmee a similar rate of return on owned facilities would be inconsistent.

- (v) Paragraphs (iv) and (v) of this definition make no distinction for Title Documents that may have differing lessor royalties or Encumbrances that either affect only one Farmor Party or affect only a portion of the Test Well Spacing Unit. If one wishes to reflect varying Payouts for different portions of the Test Well Spacing Unit, the definition would have to be varied.
- (vi) A Farmor is well advised to conduct regular audits of the Payout account to assure itself that the Farmee still retains possession of all accounting records. To conduct an audit only when the Farmor suspects that Payout has occurred is to run the risk that when the Farmor eventually conducts that audit, the Farmee will have destroyed the early and most important records for that Payout.

- (u) **"Paying Quantities"** means the anticipated output from the well of that quantity of Petroleum Substances which would reasonably warrant incurring the Completion Costs and Equipping Costs of the well considering the anticipated Completion Costs, Equipping Costs and Operating Costs associated therewith the kind and quality of Petroleum Substances indicated the anticipated availability of facilities for treating and processing such Petroleum Substances and the anticipated cost of such services the anticipated availability of markets for such Petroleum Substances the anticipated availability of transportation service for the delivery of such production to market and the anticipated cost of such service the royalties and other burdens payable by the Farmee with respect to such production the probable life of the well and the anticipated price to be received for the Petroleum Substances produced therefrom as and when sold
- (v) **"Payout"** means that date when the Farmee recovers out of the gross proceeds of sale of production of Petroleum Substances from or allocated to the Farmee's Working Interest in the Test Well (together with the cash value of all Petroleum Substances from or allocated to the Test Well delivered in kind determined when delivered) an amount equal to the sum of Farmee's Working Interest share of
- (i) all the Drilling Costs Capping Costs, Completion Costs Equipping Costs and Operating Costs for the Test Well and if applicable all costs of plugging back, re-entry and Completion recompletion reworking and re-equipping less all cash governmental incentives or grants received by the Farmee and derived from any of those operations on the Test Well
 - (ii) all costs and expenses which the Farmee incurs by payment to third parties (other than Affiliates of the Farmee) after the Petroleum Substances leave the facilities included in Equipping Costs to render merchantable and deliver to market the Petroleum Substances produced from the Test Well including expenses to transport those Petroleum Substances to the point of sale by gathering system or vehicle and to gather treat extract process and compress the Petroleum Substances in a gathering system plant or other facility used for the transportation and processing of those Petroleum Substances
 - (iii) if the Farmee or an Affiliate of the Farmee is the owner of and the Farmee makes use of facilities not included in Equipping Costs referred to in the preceding paragraph an expense equal to a fee (comprised of both operating and return on capital components) for the use of those facilities for the gathering and processing of the Petroleum Substances produced from the Test Well in accordance with (1) or (2) below as applicable
 - (1) if those facilities are or may be made available for use by third parties the fee ordinarily chargeable to those parties for the same use of those facilities as the use thereof for the Farmee's account
 - (2) in all other circumstances a fee sufficient to cover such use of facilities and operations where the capital recovery component of that fee shall provide a reasonable rate of return on the capital investment of the owners of those facilities and where the operating cost component shall be calculated and assessed in the same manner as the operating costs are calculated assessed and paid amongst the owners of that facility
- provided that if there is a dispute between or among Farmor Parties and Farmee Parties with respect to the facility usage fee that dispute shall be resolved by mediation subject to the right of any Party involved in the dispute to elect by notice to the other Parties involved in the dispute at any time during or within thirty (30) days of the conclusion or termination of the mediation efforts to have that matter referred to arbitration pursuant to the provisions of the Arbitration Act of the Province of Alberta (RSA 1991 c 43.1) as amended from time to time
- (iv) all payments for the lessor royalty for the Title Documents and the Overriding Royalty (or the cash value to the Farmee if those royalties are satisfied by delivery in kind of Petroleum Substances to the lessor and the Farmor determined when delivered)

Subclause 1 01 (y) Where there is to be a stratigraphic restriction on earning the description of zones included in the Farmout Lands in Schedule A will have to be modified by a reference to the Reserved Formations

Subclause 1 01 (bb)

- (i) Should the Spacing Unit include all zones in the Farmout Lands or should the Spacing Unit be restricted to the target zone? This definition uses the former approach which is also the approach used in industry. In other words it codifies existing practise. If the Test Well was a gas well the Spacing Unit would include crude oil and natural gas in all zones contained in the Farmout Lands (except for Reserved Formations) for the section on which the Test Well was drilled. Contrast this with the definition of spacing unit in the Operating Procedure.
- (ii) If the deepest zone penetrated by the well is the zone potentially producible the last part of the definition would include the whole zone as part of the Spacing Unit. Note that if natural gas was indicated in the Test Well the well may be Capped before it is production tested in accordance with Clause 2 03 of the Agreement.
- (iii) Whatever area the Spacing Unit was for the Test Well at earning will define the Test Well Spacing Unit and likely the Royalty Lands. Thus at least for a non-convertible Overriding Royalty the Spacing Unit concept becomes static.
- (iv) If the Overriding Royalty is convertible and if the Farmee wishes to conduct operations on the Royalty Lands prior to Payout the components of Payout and the status of the conversion become issues. See optional Article VIII of the Agreement which presents one way to overcome the static definition of Spacing Unit for convertible royalties.

Subclause 1 01 (dd) The authority may be the Target Area originally designated for a well or a waiver from the relevant regulatory authority of the originally designated Target Area.

(v) all the payments of Encumbrances (or cash value to the Farmee if satisfied by delivery in kind of Petroleum Substances to third parties determined when delivered)

(vi) all taxes paid by the Farmee and imposed by the Regulations on the equipment for and production or sale of Petroleum Substances from the Test Well (other than income taxes)

excluding from all those costs and expenses all payments made by and to the Farmee for federal goods and services taxes

(w) **"Petroleum Substances"** means petroleum natural gas and every other mineral or substance or any of them in which an interest in or the right to explore for is granted or acquired under the Title Documents

(x) **"Regulations"** means all statutes laws, rules, orders and regulations in effect from time to time made by governments or governmental boards or agencies having jurisdiction over the Farmout Lands and over the operations to be conducted thereon.

(y) **"Reserved Formations"** means the zones described as "Reserved Formations" in Schedule A and all zones included in the Farmout Lands below the base of the deepest zone earned by the Farmee in the Farmout Lands pursuant to the Agreement insofar as those formations are held by the Farmor at the Effective Date under the Title Documents or other documents of title and those zones by surface area are co-extensive with the Farmout Lands

(z) **"Royalty Lands"** means all or that portion of the Farmout Lands which when earned by the Farmee under the Agreement are subject to the reservation to the Farmor of the Overriding Royalty

(aa) **"Royalty Procedure"** means the Schedule if any attached to the Agreement entitled "Royalty Procedure"

(bb) **"Spacing Unit"** means when a well is drilled and either Completed or Capped the area allocated to the Test Well pursuant to the Regulations for the purpose of producing the Petroleum Substances therefrom for which the Test Well has been Completed or Capped from the top of the uppermost zone included in the Farmout Lands to the base of the deeper of (i) the deepest zone fully penetrated by the Test Well or (ii) the base of the deepest zone for which the Test Well has been Capped or Completed which area and zone shall be determined as of the date the well was Capped or Completed

(cc) **"Spud"** means with respect to a well that a drilling rig of adequate capacity to drill that well to Contract Depth is rigged up on location and that a drilling bit has penetrated the surface therefrom

(dd) **"Target Area"** means an area or location at which authority is given to the Farmee under the Regulations to Complete a well without subjecting the Farmee to any reduction in its allowable for production of Petroleum Substances because of the location of that well

(ee) **"Test Well"** means the well to be drilled by the Farmee under Article II (TEST WELL) of the Agreement

(ff) **"Title Documents"** means the documents of title described as "Title Documents" in Schedule A to the Agreement insofar as they relate to the Farmout Lands and all renewals extensions or continuations thereof or further documents of title issued pursuant or subsequent thereto

(gg) **"Working Interest"** means the percentage of undivided interest except for the Overriding Royalty held by a Party in the Farmout Lands or the respective zones portions parcels or parts thereof which percentage is as provided in the Agreement or as is modified subsequently pursuant to the provisions of the Agreement or this Farmout Procedure

1.02 **Singular/Plural, Masculine/Feminine**

Whenever the singular masculine or neuter is used herein or in the Agreement, the same shall be construed as meaning plural or feminine or body politic or corporate and vice versa as the context or the reference to the Parties may require.

1.03 **Optional Or Alternate Provisions**

Where alternate wording is provided for herein or in the Agreement for Articles, Clauses, Subclauses, paragraphs or any portion thereof and the Parties have failed to designate which alternate shall apply, the first alternate wording in each such case shall apply as if the Parties had designated the same, and the remaining alternate shall be deemed not to form a part hereof or of the Agreement, as the case may be. Where optional without alternate wording is provided for herein or in the Agreement for Articles, Clauses, Subclauses, paragraphs or any portion thereof and the Parties have failed to designate whether such optional wording shall be included, that optional wording shall be deemed not to form a part hereof or of the Agreement as the case may be.

1.04 **Derivatives**

For all defined terms herein or in the Agreement, a derivative of that term shall have the corresponding meaning unless the context requires otherwise.

1.05 **References To Days**

Any reference to days herein or in the Agreement is a reference to calendar days and where the phrase "within or at least" is used with reference to a specific number of days herein or in the Agreement, the day of receipt of the relevant notice or the day of the relevant event, as the case may be, shall be excluded in determining the relevant time period. However, in the event the time for doing any act expires on a Saturday, Sunday or statutory holiday in either the Province of Alberta or Canada, the time for doing that act shall be extended to the next normal business day.

1.06 **Use Of Canadian Funds**

All references to dollars or \$ shall mean lawful currency of Canada and all payments and receipts shall be made and recorded in lawful currency of Canada.

1.07 **Headings**

Article headings and any other headings or captions or indices hereto shall not be used in any way in construing or interpreting any provision hereof.

1.08 **References**

The references hereunder, herein and hereof refer to the provisions of this Farmout Procedure and unless otherwise expressly stated, references to Articles, Clauses, Subclauses or paragraphs herein refer to Articles, Clauses, Subclauses or paragraphs of this Farmout Procedure.

1.09 **Conflicts**

If any provision contained in the Agreement conflicts with a provision herein, the provision in the Agreement shall prevail. In the event of a conflict between any provision in the Agreement or this Farmout Procedure and the Regulations or the Title Documents, the Regulations or the Title Documents, as the case may be, shall govern except that (i) the Working Interests shall prevail if there is a difference between the Working Interests and the registered interests in the Title Documents and (ii) the allocation of responsibility for losses as provided herein (including Article X entitled "LIABILITY AND INDEMNITY") shall govern the relationship of the Parties. If there is a conflict as provided above, the Agreement or the Farmout Procedure shall be modified accordingly to the extent necessary to resolve such conflict and as so modified shall continue in full force and effect.

Clause 1 10

- (i) This provision is necessary if there are multiple Farmee Parties
- (ii) The optional paragraphs would be used when multiple Farmee Parties have not made arrangements among themselves as to drilling of the Test Well

Clause 1 11 This provision is necessary if there are multiple Farmor Parties

1.10 Multiple Farmee Parties

If the Farmee comprises more than one Party

- (a) the Farmee Party's obligations and liabilities to the Farmor shall be joint and several
- (b) _____ is designated as the representative of the Farmee (hereinafter called the Managing Farmee)
- (c) the Farmor shall be entitled to deal solely with the Managing Farmee with respect to matters arising under the Agreement or the Farmout Procedure
- (d) the Farmee shall not change the Managing Farmee without the written consent of the Farmor which shall not be unreasonably withheld

The following optional paragraphs shall not _____/shall _____ (Specify) be included herein

From the Effective Date the rights and obligations of the Farmee Parties amongst themselves with respect to the Test Well shall be subject to the 1990 Canadian Association of Petroleum Landmen's form of operating procedure (hereinafter called the 1990 Operating Procedure) with the following amendments

- (i) *Clauses 101(f) (g) (j) (n) (r) (s) (t) (z) (ff) 310 311B 505(b) (v) 601 to 608 inclusive 901 to 905 inclusive 1001 to 1022 inclusive 1101 to 1106 inclusive 1301 1401 to 1409 inclusive 1501 first sentence 2301 and 2401 to 2404 inclusive shall not apply and*
- (ii) *The definitions of joint lands Operator and working interest shall be deleted and replaced as follows*
 - (p) *joint lands shall mean those lands and interests therein which have been made subject to the Agreement or so much thereof which remains subject thereto and shall include petroleum substances within upon or under those lands and interests as far as those lands and interests are subject to the title documents and for which the parties continue to hold a right to earn an interest therein pursuant to the Agreement*
 - (u) *Operator shall mean the Managing Farmee designated under Clause 1.10 (Multiple Farmee Parties) of the Farmout Procedure*
 - (ff) *Working Interest shall mean the percentage of undivided interest in the joint lands for which a party continues to hold a right to earn pursuant to the Agreement which percentage is as provided in the Agreement or as modified subsequently pursuant to the provisions hereof*

Clauses 1201 to 1203 inclusive shall apply to the Test Well as among the Farmee Parties before notice of abandonment is given to the Farmor under Article IX of the Farmout Procedure. If the application of these Clauses results in changes in the Working Interests in certain zones of the Farmout Lands as among the Farmee Parties the Working Interests and if applicable the Operator designated for the Operating Procedure in the Agreement shall be modified to the extent necessary to reflect such changes for that portion of the Farmout Lands affected

1.11 Multiple Farmor Parties

If the Farmor comprises more than one Party all information and notices to be provided to the Farmor by the Farmee shall be provided individually to each Party comprising the Farmor and all elections provided to the Farmor shall be made individually by each Party comprising the Farmor. An election by a Farmor Party shall not obligate any other Farmor Party to make any election

Clause 2.01

- (i) Paragraph (b) references notices of default. If there are potential offset obligations or if offset obligations exist for which there have been no notices of default, they should be referenced in this Clause or perhaps in the Agreement.
- (ii) The Encumbrances recognized under the last sentence become exceptions under Clause 802 of the Operating Procedure. The Agreement creates the Overriding Royalty so it is already covered by Clause 802 of the Operating Procedure. See also Subclause 5.02(b) of the Agreement.

Clause 2.02

- (i) This Clause requires the Farmor to allow the Farmee the option of having penalties or compensatory royalty payments made for the Farmee's account to preserve those lands in the Farmout Lands. This issue is usually not addressed in farmout agreements except to provide that the Farmor is under no obligation to make such payments. As the Farmee may be interested in the lands subject to the penalty or compensatory royalty, the authors decided the Farmee should have the option of having that payment made for its account.
- (ii) If the penalty or compensatory royalty payment was known or probable at the time the farmout was made, the Parties would likely deal with the issue directly in the Agreement rather than relying on the operation of this Clause.
- (iii) What if the Farmee has not earned but wishes to drill the lands affected by the offset obligation or security payment? The Parties should discuss the matter to attempt to arrive at an appropriate course of action in the context of the particular fact situation.
- (iv) Note that these payments are not allocated on a per diem basis. If, for example, the Farmor incurs the penalty (i.e., Section 97) to maintain a portion of the Farmout Lands in good standing for the Farmee, the Farmee would reimburse the Farmor 100% of that amount regardless of the date on which the Farmee earns or drops its option.
- (v) If the Farmee reimburses the Farmor for a penalty and then conducts operations entitling the Farmor to a refund, the resultant refund would be passed on to the Farmee.
- (vi) While rentals are relatively straightforward, continuation type payments can be quite varied. If a deal concerns Title Documents nearing or past their primary term or if there are offsetting wells, both the Farmor and Farmee will wish to look at the Farmout Lands closely. The Farmee will want the Farmor to keep the Farmout Lands alive at least as long as it would take for the Farmee to earn in same. The Farmor wishes to be compensated for whatever payments are required to do so.
- (vii) The CAPL freehold petroleum and natural gas lease makes provision for a compensatory royalty to satisfy an offset obligation.
- (viii) See Article VIII for the treatment of rentals and shut-in payments.

Clause 2.03

- (i) It is important for the Farmor to disclose all the Encumbrances on the Farmout Lands that it expects the Farmee to share. Compare this Clause with Article VIII of the Operating Procedure.
- (ii) This Clause does not apply to mutual interest lands and those lands may be already encumbered.

II. TITLE AND ENCUMBRANCES

2.01 Farmor Makes No Warranty Of Title

The Farmor neither represents nor warrants title to the Farmout Lands nor agrees that the Farmee will earn any better interest in the Farmout Lands than the Farmor now has under the Title Documents. Notwithstanding the foregoing sentence the Farmor represents that:

- (a) the Title Documents for the Farmout Lands are subject to the Encumbrances, if applicable and the Farmor or any of its Affiliates has not granted any interest or right to earn any interest in the Farmout Lands except for the Encumbrances or as specifically provided in the Agreement and
- (b) the Farmor or any of its Affiliates has not on or before the date of execution and delivery of this Agreement, received any notice of default for the Farmout Lands which has not been remedied.

The Working Interest earned by the Farmee pursuant to the Agreement shall be subject to the Encumbrances which shall continue to apply to that Working Interest following the application of the surrender forfeiture or production penalty provisions of the Operating Procedure to that Working Interest, as applicable

2.02 Maintaining Title Earning Phase

For the period from the Effective Date until the Farmee has earned an interest in the Farmout Lands pursuant to the Agreement or its right to do so ceases or the Agreement is terminated whichever occurs first the Farmor shall not grant any interest in the Farmout Lands and shall not do or cause to be done any act or omission whereby the Farmout Lands become encumbered terminated or forfeited

If after the Effective Date (i) the payment of a security or penalty pursuant to the Regulations is required to be paid to maintain any portion of the Farmout Lands not then earned by the Farmee in which the Farmee's right to earn has not terminated or (ii) the payment of compensatory royalty is required pursuant to the terms of the Title Documents (which payment or obligation may be avoided by surrendering all or a portion of the Title Documents to the grantor thereof) to maintain such lands the Farmor shall give immediate notice of same to the Farmee. On or before the 10th day of the Farmee's receipt of that notice or such lesser period as the Regulations or the Title Documents may require the Farmee may elect by notice to the Farmor to have that payment made for the Farmee's account. Failure to elect within the time specified shall be deemed to be an election not to have that payment made for the Farmee's account.

If the Farmee elects to have that payment made for its account the Farmor shall pay same to the extent necessary to maintain the affected Farmout Lands and the Farmee shall reimburse the Farmor for one hundred percent (100%) of the Farmor's share of such payment within thirty (30) days of receiving an invoice for same. If the Farmee fails to reimburse the Farmor for those payments in the time specified in this Clause the Farmee's election to have that payment made for its account shall be deemed revoked effective as of the date of such default and the following sentence shall apply mutatis mutandis provided that nothing in this Clause shall relieve the Farmee from any obligations accrued to that date including the obligation to reimburse the Farmor for such payments. If the Farmee does not elect to have that payment made for its account the Farmor may do so and the lands so maintained or the lands which would otherwise have been surrendered or if the Farmor does not so pay the affected lands shall be removed from the definition of Farmout Lands and the Farmee's right to earn in those lands shall terminate effective as of the date the Farmee elected or was deemed to have elected not to have that payment made for its account.

Insofar as operations conducted under the Agreement by the Farmee entitle the Farmor to recover from the grantor of the Title Document all or a portion of the amounts paid by the Farmee the Farmor shall apply for such reimbursement and forward such amount to the Farmee promptly

2.03 Responsibility For Encumbrances

Where the interest of any Party in the Farmout Lands is now subject to or becomes subject to any charge security interest royalty (other than a royalty under the Title Documents or the Overriding Royalty)

Article III This Article is more stringent and detailed than the information provisions of the Royalty Procedure and the Operating Procedure. As well, the Farmor is allowed to conduct additional tests at various points. The authors believed this treatment was warranted because the Test Well is an earning well. The Farmor is giving up a Working Interest in the Farmout Lands in consideration for the drilling of the Test Well (which will evaluate the Farmout Lands) so the Farmor is very interested in gleaning as much information as it can from that well. At the same time, the drilling of the Test Well is the Farmee's operation, and it is the Farmee that has come up with a play on the Farmout Lands. Therefore, it wishes to have control of the operations. The authors have attempted to balance the needs of both the Farmor and Farmee in this Article.

Clause 3.01 The first two Subclauses are an attempt to recognize the concept of well requirement sheets common in the industry. Subclause (c) is derived from Clause 706 of the Operating Procedure.

Subclause 3.02(a) If the Farmor had zones it wished tested (perhaps shallower than the Farmee's objective) or wished to have particular tests run, the Farmor should specify same in the Agreement.

production payment or any other burden or encumbrance other than the Encumbrances (hereinafter collectively called Charges in this Clause) the Party whose interest is or becomes subject to a Charge shall bear and pay for that Charge and all related liabilities and shall indemnify and save harmless the other Parties from all liabilities for same which indemnity shall include the obligation of the indemnifying Party to the indemnified Party for interest on any amount incurred or paid for that Charge by or for the account of the indemnified Party. Clause 12.03 (Farmor's Right To Charge Interest For Financial Default) shall apply to all amounts incurred or paid by the indemnified Party. The indemnified Party may set off any liabilities incurred or paid with respect to a Charge including accrued interest thereon against any obligation owed by the indemnified Party to the indemnifying Party under the Agreement (or any Schedule thereto) or any other agreement between those Parties whether entered into before or after the Effective Date.

III INFORMATION TO FARMOR TEST WELL

3.01 Farmor's Well Information Requirements

(a) Number Of Copies Or Samples

The Farmor may give notice to the Farmee specifying a reasonable number of copies of reports or number of samples it wishes to receive of any report or sample which the Farmee is to forward to the Farmor by virtue of this Article. If the Farmor fails to give such notice or no number is specified for the test or sample concerned the Farmee shall forward one (1) copy or sample as the case may be to the Farmor.

(b) Farmor To Nominate Recipient Of Information

The Farmor may by notice to the Farmee nominate a reasonable number of agents or employees of the Farmor to be its representatives to receive all or any portion of the information which is to be provided under this Article and the Farmee shall forward such information to the representatives so nominated.

(c) Data Supplied In Accordance With Established Standards

The Farmee shall supply all data to be provided to the Farmor under this Article in accordance with established industry standards.

3.02 Test Well Information

(a) Precommencement Information

Prior to the proposed Spud date of the Test Well the Farmee shall submit to the Farmor the proposed program for drilling drilling mud logging coring testing and casing (which program as shall hereinafter be called the Drilling Program) for that Test Well along with the prognosis of all formation tops to be penetrated by the Test Well. Prior to commencing the drilling of the Test Well the Farmee shall provide the Farmor with

(i) notice of intention to drill at least 48 hours prior to the proposed Spud date and

(ii) a copy of the well location survey and the application for well license.

The Farmee shall drill the Test Well in material accordance with the Drilling Program.

(b) Drilling Information

The Farmee shall give notice to the Farmor when the Test Well is Spudded and shall furnish the Farmor with accurate daily progress reports by telefacsimile (or by any other like method by which a written and recorded message may be sent) of current Test Well wellsite activities including

Subclause 3.02 (e)

- (i) This procedure does not address the type or nature of the authorization required to gain access to the site. Technical personnel of the respective companies should address this. Alternatively, one could expand this Subclause to contain the mechanics of authorization.
- (ii) The Regulations that could restrict the Farmor's access to the well are the ERCB rules on sour gas wells. If a Farmor wished to ensure it could have access to the well, it should arrange to have the Emergency Response Plan provide for same. This access consideration also arises with regard to the logs and tests to be run pursuant to Subclauses (f) and (h) respectively.

- (i) details of current operations,
- (ii) total depth and depth at which current operations are being conducted
- (iii) deflection and deviation surveys,
- (iv) the character names depths and sample descriptions of formations penetrated
- (v) intervals recovery and description of cores taken
- (vi) results of formation tests,
- (vii) shows of Petroleum Substances and water and
- (viii) the attainment of Contract Depth

(c) Drilling Samples And Analysis

In addition to the cores prescribed in the Drilling Program the Farmee is authorized to take such further cores from zones included in the Farmout Lands as it deems necessary to evaluate such zones. If and to the extent requested by the Farmor the Farmee shall also take additional cores at the Farmor's risk and expense. The Farmee shall make all such cores available for inspection and examination by the Farmor as soon as practicable after the cores have been pulled. If an analysis of any core is made the Farmee shall promptly furnish the Farmor with a report of such analysis. The Farmee shall collect samples of formation cuttings at intervals prescribed the Regulations and with respect to intervals contained in the Farmout Lands penetrated by the Test Well and to the extent requested by the Farmor shall promptly furnish to the Farmor washed and dried samples taken at each such interval identified as to the depth at which such samples were taken.

(d) Fluid Samples And Analyses Requested By Farmor

If and to the extent requested by the Farmor the Farmee shall collect samples of all fluid samples recovered from the Test Well in containers supplied by the Farmor and forthwith send an uncontaminated sample of every such fluid to the Farmor identified as to the depth at which it was taken. If an analysis of such fluids is made the Farmee shall promptly furnish the Farmor with a report of such analysis.

(e) Derrick Floor Access

The Farmee shall give the Farmor's authorized representatives at the Farmor's sole risk, cost and expense and upon reasonable notice access to the Test Well and the derrick floor at all times for the purpose of inspection observation and acquiring information on behalf of the Farmor except to the extent the Regulations restrict such access.

(f) Logging Information

In addition to the electrical radioactivity or acoustic surveys or other geophysical surveys prescribed by the Drilling Program the Farmee is authorized to take such further surveys of a similar nature in the Test Well wellbore for zones included in the Farmout Lands as it deems necessary to evaluate such zones. The Farmee shall give the Farmor prior notice of when any survey is to be run so that the Farmor's representatives may be present to witness that survey or operations with respect thereto except to the extent the Regulations restrict such access. The Farmee shall promptly furnish the Farmor with authentic copies of the logs and records of such surveys (excepting seismic velocity surveys) and provide if available access to digital tapes.

(g) Additional Logging Information Requested By Farmor

When the Farmee has completed that portion of the Drilling Program pertaining to the surveys referenced in the immediately preceding Subclause the Farmor may request additional electrical

Subclause 3 02 (i)

- (i) During drilling the Farmee may discover something leading it in a different direction than it initially planned. If the Farmor had specified certain testing requirements in the Agreement it may wish to add some sort of restriction on material alterations or to add a provision whereby the Farmor would have the opportunity to object to material changes.
- (ii) These deviations will be at the sole cost of the Farmee but will be added to the Payout account thereby delaying the Farmor's conversion.
- (iii) Clause 2 02 of the Agreement required the Farmee to drill the Test Well within a Target Area (unless the Farmor's consent was obtained) on the Farmout Lands or perhaps at a specified location. The Farmee may alter its Drilling Program but not by drilling or Completing the Test Well in contradiction to Clause 2 02 of the Agreement.

Subclause 3 02(k) Most farmout agreements allow the Farmor to conduct tests prior to Abandonment (see Clause 9 02). This Subclause allows that some opportunity prior to Capping or Completion

Subclause 3 02(l)

- (i) When the Farmee has Capped the Test Well sufficiently to earn the Farmout Lands the Farmee is to send a final report to the Farmor. See Clause 2 03 and 3 01 of the Agreement.
- (ii) Clause 3 02 of the Agreement specifies the extent to which Abandonment must be conducted to achieve earning.
- (iii) Clauses 2 03 and 3 01 of the Agreement specify that conditional earning will occur when the Farmee Caps the Test Well. At that point a final report would be made. However the Farmout Procedure applies when the Farmee goes back into the well to Complete or Abandon the Test Well to remove the earning conditions. Therefore though this Subclause references a final report in situations where the Test Well is Capped further information may have to be provided to the Farmor.

radioactivity or acoustic surveys or other geophysical surveys (excepting seismic velocity surveys) to be conducted in any part or all of the Test Well wellbore. The Farmee shall conduct these surveys on behalf of the Farmor at the Farmor's risk and expense. The immediately preceding Subclause shall apply to those surveys mutatis mutandis.

(h) Testing Information

The Farmee shall properly test and evaluate each prospective porous zone of the Farmout Lands reasonably anticipated to contain Petroleum Substances in Paying Quantities penetrated by the Test Well in accordance with the Drilling Program and to the reasonable satisfaction of the Farmor. Upon encountering any such zone, the Farmee shall give the Farmor prior notice of when such zone is to be tested and evaluated so that the Farmor's representatives may be present to witness tests or operations with respect thereto, except to the extent the Regulations restrict such access. The Farmee shall furnish the Farmor immediately with all information relating to each and every formation or production test, including bottomhole pressure charts and copies of each formation test report.

(i) Program Amendment

If at any time prior to the Completion or Abandonment of the Test Well, the Farmee desires to alter materially any portion of, or to make a material addition to, the Drilling Program (other than those alterations or additions required by the Farmor pursuant to the preceding Subclauses of this Clause), the Farmee shall, prior to commencing any such alteration or addition, submit same by notice to the Farmor. Nothing in this Clause shall permit the Farmee to drill, Cap or Complete the Test Well at a location other than that specified by the Agreement.

(j) Completion Program

If the Farmee wishes to Complete the Test Well, it shall, prior to the commencement of same, submit the proposed Completion program to the Farmor.

(k) Additional Tests Requested By Farmor On Capping Or Completion

If the Farmee intends to Cap or Complete the Test Well, the Farmee shall give notice of same to the Farmor and shall supply the Farmor with all material information the Farmee is obligated to provide the Farmor concerning that well pursuant to this Article. Within twenty-four (24) hours of receipt of the Farmee's notice and such information where a drilling rig capable of conducting the Capping or Completion is on location, and within fifteen (15) days of receipt of the Farmee's notice and information in all other cases, the Farmor may elect, by notice to the Farmee, to have further tests (other than production tests) conducted on the well at the Farmor's cost, risk and expense. If the Farmee reasonably believes that the condition of the wellbore permits, the Farmee shall conduct the tests specified in the notice in a timely manner on behalf of the Farmor.

(l) Report Upon Capping, Completion Or Abandonment

Upon Capping, Completion or Abandonment of the Test Well to the extent required for the Farmee to earn the Farmout Lands, the Farmee shall supply the Farmor with a final report which shall include:

- (i) a complete summary of the drilling, Capping, Completion or Abandonment of the well;
- (ii) a complete summary of the casing program at each casing interval;
- (iii) a complete summary of cored intervals and descriptions of the core and any shows of Petroleum Substances;
- (iv) a list of all well logs and depth intervals thereof;
- (v) a list and description of all formation tops.

Clause 3 03

- (i) As the Agreement contains the concept of conditional earning and the Royalty Procedure restricts the information that is given to the Farmor/Royalty Owner for non-convertible royalties this Clause ensures the Farmor obtains all information for the Test Well through Completion or Abandonment.
- (ii) If the Farmee Caps the Test Well and then later Completes the well this Article applies As the Farmee would then have earned unconditionally pursuant to Clause 3 01 of the Agreement the Royalty Procedure or the Operating Procedure as the case may be would cover the information to be given on a subsequent re completion

Clause 4 03 This optional Clause may be utilized where the Farmee is unknown to the Farmor and wishes to ensure performance

- (vi) a summary of the open hole drillstem wireline and production tests
- (vii) a log or written description of cuttings, and
- (viii) a copy of the hydrocarbon mud log

3 03 Application Of Information Article Upon Capping

If the Farmee has conditionally earned a Working Interest in the Farmout Lands pursuant to the Agreement by Capping the Test Well this Article shall apply to the Farmee's operations with respect to the Test Well including the attempt to Complete that well or the Abandonment of that well. When the Farmee has unconditionally earned a Working Interest in the Farmout Lands pursuant to the Agreement the Royalty Procedure or the Operating Procedure as applicable shall apply to the Test Well with regard to the information to be provided to the Parties.

IV OPERATIONS AND LIENS

4 01 Operations Conducted In Proper Manner

The Farmee shall conduct all operations conducted by it diligently in a good and workmanlike manner in accordance with good oil field practice and in compliance with the Regulations and the provisions of the Title Documents. Insofar as the Farmee hires contractors to conduct any part of such operations the Farmee shall supervise those contractors to the extent reasonably necessary to ensure that those contractors conduct their work in the same manner.

4 02 Protection From Liens

For the Farmee's operations on the Farmout Lands the Farmee shall

- (a) pay or cause to be paid as they become due and payable all accounts of contractors and claims for wages or salaries for services rendered or performed for the Farmee and for materials supplied to the Farmee
- (b) keep the lands free from liens and encumbrances resulting therefrom unless and to the extent there is a bona fide dispute with respect thereto and
- (c) not permit any dues or claims from any Workers Compensation Board or similar authority established under the Regulations to become in arrears

Optional Clause 4 03 shall not ____/shall ____ (Specify) be included herein

4 03 Security For Farmee's Liabilities

If requested by the Farmor the Farmee shall secure in favour and to the satisfaction of the Farmor the Farmee's liabilities for the drilling and Abandonment of the Test Well as soon as practicable after the Farmor's request. Such security may include either an irrevocable standby letter of credit or a performance bond and shall be effective at least up to 120 days after the Test Well is Spudded. If those liabilities are to be secured by an irrevocable standby letter of credit, the Farmee shall establish and cause to be issued that letter of credit in favour of the Farmor with a chartered bank conducting business in Canada. If the Farmee defaults in the payment and discharge of its liabilities hereunder or under the Agreement, the Farmor may draw upon or take proceedings under the security issued to the Farmor by or on behalf of the Farmee to fully discharge those liabilities.

Clause 4 04 This optional Clause may be utilized to provide the Farmor with protection when the Farmor chooses to enter the Farmout Agreement with a Farmee of whose financial circumstances the Farmor may be unsure

Clause 5 01

- (i) One issue with respect to a substitute well provision is whether the substitute well should be mandatory or optional. Usually the provision is academic except for wells in i) the foothills ii) areas with limited regional well control and iii) other selected high-cost/limited accessibility areas. Nevertheless a consensus between the Farmor and Farmee must be made on a may or shall format. In support of the shall format the Farmor wants a well drilled to evaluate the Farmout Lands and the Farmee committed to do just that. If the Title Documents are nearing expiry there may not be time to find another Farmee. In support of the may format the Farmee spent money to get the well to the impenetrable formation. Starting a new well could destroy its economics and it should not be forced to spend money in an uneconomic project. More importantly the impenetrable formation could well cover all the lands on which the Farmee is allowed to Spud a well which is all the more likely if the Farmee was restricted to a single Spacing Unit in which to drill. Why should the Farmee be forced to put down a well when it believes it cannot reach Contract Depth? The authors opted for the may format. The Farmee earns nothing under the Agreement because the Test Well did not reach Contract Depth so Farmees are not likely to abuse this Clause.
- (ii) If a Farmor had reserved some shallow formations it may take over the wellbore so it could test or develop those shallow zones. As well if the Farmee did not drill a substitute well the Farmor may desire a chance to test or develop Farmout Land zones not so reserved.

Article VI This insurance article relates only to earning wells. The Operating Procedure and the Royalty Procedure have similar provisions.

Clause 6 01

- (i) The opening sentence is derived from the opening sentence of Clause 311 and Paragraph 311 (g)(i) both of the Operating Procedure.
- (ii) Alternate A is derived from Alternate A for Clause 311 of the Operating Procedure with the addition of blowout insurance. If the parties know enough about the area of the Farmout Lands that no sour gas or high pressures will be encountered one may wish to delete this requirement. Even without such area knowledge one could delete this requirement if the Farmor had sufficient confidence in the Farmee. Blowout insurance is expensive and a Farmee should not be required to obtain it if there is no need.
- (iii) Alternate B is derived from the first sentence of Clause 311 Alternate B in the Operating Procedure.

Optional Clause 4.04 shall not ____/shall ____ (Specify) be included herein

4.04 Payment Of Costs

Before delivery of any assignments to which reference is made in Clause 3.01 (Test Well Earning) of the Agreement, and if the Farmor requests the Farmee shall supply the Farmor with satisfactory evidence of the payment of all claims and accounts including affidavits and statutory declarations together with such supporting documentation as the Farmor may reasonably request, to the effect that, with due examination of the Farmee's records the Farmee has paid all outstanding liabilities for the costs and expenses incurred by the Farmee for its operations to earn the Farmout Lands

V SUBSTITUTE WELL

5.01 Drilling Of Substitute Well

If prior to attaining Contract Depth the Farmee encounters mechanical difficulties or impenetrable formations which, in the Farmee's opinion make further drilling of the Test Well impractical the Farmee shall immediately give notice thereof to the Farmor providing therein the reasons further drilling of the Test Well is impractical. The Farmee shall Abandon that well subject to Article IX (ABANDONMENT OF TEST WELL) which shall apply mutatis mutandis provided that if the Farmee earns an interest in the Farmout Lands by virtue of a substitute well the first sentence of Clause 9.05 (Effect On Farmee's Interest) shall not apply. The Farmee may Spud a substitute well at another location permitted for the drilling of the Test Well on the Farmout Lands within the sooner of 30 days after the rig release date of the rig conducting the Abandonment of that first well or 60 days prior to the termination date of any of the Title Documents on which the Test Well is permitted to be drilled. All rights and obligations hereunder or under the Agreement for a Test Well shall apply mutatis mutandis to the substitute well.

VI INSURANCE

6.01 Farmee Obligated To Carry Insurance

The Farmee shall comply and shall use every reasonable effort to have its contractors and subcontractors comply with the requirements of all unemployment insurance, workers' compensation and occupational health legislation and all similar Regulations with respect to workers employed in operations conducted hereunder or under the Agreement by or on behalf of the Farmee. The Farmee shall also comply with the provisions of ALTERNATE ____ below (Specify A or B).

ALTERNATE A.

The Farmee shall, prior to the commencement of operations hereunder or under the Agreement, and at its sole cost hold or cause to be held with a reputable insurance company or companies and thereafter maintain or cause to be maintained for the benefit of the Parties and their respective Affiliates, directors, officers, consultants, agents and employees the insurance hereinafter set forth and any other insurance which is specifically required to comply with the Regulations with respect to such operations. The insurance required pursuant to this Clause shall apply to each separate claim and shall be as follows:

- (i) automobile liability insurance covering all motor vehicles or snowcraft and all terrain vehicles owned or non-owned, operated or licensed by the Farmee to the extent they are used in such operations with an inclusive bodily injury, death and property damage limit of one million dollars (\$1,000,000) per accident*
- (ii) comprehensive general liability insurance with an inclusive bodily injury, death and property damage limit of one million dollars (\$1,000,000) per occurrence and, without restricting the generality of the foregoing provisions of this paragraph, such coverage shall include but not be limited to employer's, employer's contingent liability, contractual liability, contractor's protective liability, products and completed operations liability*

Clause 6 02. Paragraphs (a) (b) and (c) correspond to condition (a) condition (d) and condition (g) (ii) respectively of Clause 311 in the Operating Procedure

Article VII Both versions apply to the Payout status of a well It is conceivable that a Farmee may be subject to an audit both under this procedure (for Payout) and under the Royalty Procedure (for the Overriding Royalty) Alternate B is more stringent than Alternate A, particularly with regard to record retention Partially this is due to the nature of Payout (i e a one time event that may occur many years after earning) It is also a reflection of the Farmor's desire to ensure it is given its right to convert to a Working Interest at the proper point in time

Despite the advantages of Alternate B the authors decided that an Alternate A such as this was desirable since it is based on the 1988 Petroleum Accountants Society of Canada form of accounting procedure (the Accounting Procedure) With more industry experience with this form the authors expect future versions to have only one audit Article

Alternate A.

- (i) The 26 month period comes from Clause 107(a) of the Accounting Procedure while the 24 month and 6 month periods come from Clause 108 of that procedure
- (ii) The last sentence of Clause 7 01 is added for the benefit of Farmees who feel a gas sale contract for their production is proprietary data and should not be subject to disclosure on an audit This is consistent with the last phrase of Clause 607 of the Operating Procedure
- (iii) Note the reference to mediation and arbitration in Clause 7 02 Many companies are reluctant to go to court because of the cost (both in terms of money and time) and formality such actions would entail Arbitration is less formal and costly but still sufficiently so that companies may wish to avoid going that route Mediation is less formal and costly still but not as established as arbitration The authors decided to allow any party to a dispute to take a matter from mediation to arbitration whether as a form of appeal or as a way to move matters along should mediation efforts break down This concept is also found in Clause 7 05 of Alternate B
- (iv) The rationale for optional Clause 7 03 is that the Farmee should keep good records If an audit discloses that those records were in error to some significant degree the cost for the audit should be borne by the Farmee This concept is also used in Clause 7 06 of Alternate B
- (v) A Farmor is well advised to conduct regular audits of the Payout account to assure itself that the Farmee still retains possession of all accounting records To conduct an audit only when the Farmor suspects that Payout has occurred is to run the risk that when the Farmor eventually conducts that audit the Farmee will have destroyed the early and most important records for that Payout

- (iii) *aircraft liability insurance covering all aircraft, owned or non owned, operated or licensed by the Farmee to the extent they are used in such operations with an inclusive bodily injury death and property damage limit of five million dollar (\$5 000 000) per occurrence and*
- (iv) *control of well insurance (including sudden accidental pollution) of a minimum of ____ million (\$ _____) per occurrence*

ALTERNATE B

The Farmee shall, prior to the commencement of operations hereunder or under the Agreement, and at its sole cost, hold or cause to be held with a reputable insurance company or companies and thereafter maintain or cause to be maintained for the benefit of the Parties and their respective Affiliates directors officers consultants agents and employees only that insurance as is specifically required to comply with the Regulations

6.02 Conditions Applicable To Insurance

- (a) The amount of the deductible specified for each accident or occurrence in any insurance policy maintained pursuant to this Article shall not exceed twenty five thousand dollars (\$25 000) without the prior approval of the Farmor not to be unreasonably withheld
- (b) The Farmee shall use reasonable efforts to ensure that each insurance policy maintained pursuant to this Article includes a provision that coverage is primary to any other coverage carried by the Farmee (other than coverage maintained by the Farmee to reduce its exposure to a deductible) a provision that such policy shall survive the default or bankruptcy of the insured for claims arising out of an event before such default or bankruptcy and a provision that the insurer shall provide the Farmee with sixty (60) days written notice of cancellation of such policy The Farmee shall give notice to the Farmor immediately upon receipt of notice of cancellation
- (c) The Farmee shall ensure that each insurance policy maintained pursuant to this Article includes waivers of all rights by subrogation or otherwise against the Farmor and its respective Affiliates directors officers consultants agents and employees
- (d) Upon request of the Farmor the Farmee shall promptly provide the Farmor with evidence of full compliance with this Article including a copy of any particular policy of insurance if so requested by the Farmor

ARTICLE VII ALTERNATE ____ (Specify A or B) shall apply

ARTICLE VII ALTERNATE A.

VII AUDITS OF PAYOUT ACCOUNT

7.01 Examination Of Records

The Farmor may upon reasonable notice to the Farmee and at the Farmor's own expense audit the books, records and accounts of the Farmee with respect to the Payout status of the Test Well at any time up to and including the calendar year in which the Farmor receives notice from the Farmee that Payout has been attained with respect to such well and the twenty four (24) month period next following the end of that calendar year Notwithstanding the foregoing sentence the Farmee shall not be required to provide the auditors with access to any contract pursuant to which the Farmee sold its share of Petroleum Substances

7.02 Discrepancies And Settlements

Any claims of discrepancies disclosed by an audit conducted pursuant to the preceding Clause shall be made in writing to the Farmee within two (2) months following the completion of the audit The Farmee shall respond in writing to any claims of discrepancies within six (6) months of receipt of the claims To the

Alternate B

Clause 7.01

- (i) The definition for **Examine and Technical Records** may go beyond the type of search or information usually considered subject to audit. The last phrase of the definition of **Technical Records** is intended to prevent the Farmor from obtaining information through audit that it would not otherwise obtain.
- (ii) The last phrase of the definition of **Financial Records** serves the same purpose as the last sentence of Clause 7.01 in Alternate A.

extent that the Parties are unable to resolve any outstanding claims of discrepancies disclosed by the audit such audit exception shall be resolved by mediation provided that, at any time during or within thirty (30) days of the conclusion or termination of the mediation efforts, any Party involved in the audit exception may elect by notice to other Parties involved to have such audit exception resolved pursuant to the Arbitration Act of the Province of Alberta (RSA 1991 c 43 1) as amended from time to time

However any statement rendered by the Farmee to the Farmor with respect to the Payout status of the Test Well shall be deemed to be correct twenty-six (26) months following the end of the calendar year in which the statement was received by the Farmor unless and to the extent that the statement is disputed by the Farmor before the end of that period Upon resolution of a claim of discrepancy the Farmee shall amend the Payout account as required to reflect that resolution

Optional Clause 7 03 shall not _____/shall _____ (Specify) be included herein

7 03 Discrepancies Causing Farmee To Pay For Audit

Notwithstanding Clause 7 01 (Examination Of Records) if the claims of discrepancy upon resolution, cause changes to the Farmee s books records and accounts which

- (i) if Payout has not been achieved for the Test Well reduce the amount of money remaining to achieve Payout by more than ____% of the amount calculated by the Farmee to achieve Payout as of the date that well first commences production of Petroleum Substances or*
- (u) if Payout has been achieved for the Test Well, change the date upon which Payout was achieved by more than ____ months*

the Farmee shall pay to the Farmor immediately upon receipt of an invoice for same the reasonable costs of the audit of the Payout account to which the claims of discrepancy relate

ARTICLE VII ALTERNATE B

VII RECORDS AND AUDIT OF PAYOUT ACCOUNT

7 01 Definitions For Records And Audit

In this Article the following words and phrases shall have the following respective meanings namely

- (a) Claim means any assertion by the Farmor of any Discrepancy
- (b) Discrepancy means any inaccuracy inconsistency or error with respect to any Financial Records
- (c) Examine means (i) with respect to any Financial Records to inspect verify review copy audit or any combination of the foregoing and (ii) with respect to Technical Records to inspect or copy or both
- (d) Financial Records means all accounts and supporting records of the Farmee with respect to all transactions bearing directly or indirectly on operations conducted by the Farmee pursuant to the Agreement insofar as they affect the calculation of Payout for the Test Well excluding any contract pursuant to which the Farmee sold its share of Petroleum Substances
- (e) Records means Financial Records and Technical Records and
- (f) "Technical Records means all records of the Farmee other than Financial Records with respect to the operations conducted by the Farmee pursuant to the Agreement to the extent that such records do not constitute the Farmee s proprietary data or interpretation of data

Clause 7.03 The time period for which the Farmee is required to retain records may be much longer than required by Regulations if Payout occurs over a long period. The Farmor's audit rights would be illusory if the Farmee were not required to retain records at least to the end of the Payout period. There is no 26 month deemed correctness rule like there is in Alternate A.

Clause 8.01 This Clause refers to rentals and shut in payments (or suspended well payments as they are called in the CAPL freehold petroleum and natural gas lease form). Usually these payments are relatively small so this Clause requires the Farmor to pay same to maintain the Farmout Lands subject to reimbursement pursuant to Clause 8.02, no election is provided like Clause 2.02.

7.02 Standards Of Record Keeping

The Farmee shall create and maintain in the Province of Alberta, Financial Records in accordance with Canadian Generally Accepted Accounting Principles (GAAP) and Technical Records in accordance with generally accepted industry standards.

7.03 Retention Of Records

The Farmee shall retain Records until the later of (i) 2 years after the end of the calendar year in which the Farmor receives notice that Payout has been attained, or (ii) the period of time prescribed by the Regulations. In the event of a Claim the Farmee shall keep Records until such Claim is finally resolved and for such longer period of time as the Farmor may reasonably request.

7.04 Examination Of Records

The Farmor may from time to time and at its expense have its representatives examine any of the Records at any time up to the end of that period for which the Farmee is required to keep Records pursuant to the previous Clause. The Farmee shall provide reasonable assistance and facilities to those conducting an Examination including the conversion to a readily understandable format of those Records kept in electronic format or in any other format which cannot be readily understood without special equipment or specialized knowledge.

7.05 Discrepancies And Settlements

The Farmor may give notice of a Claim to the Farmee within two (2) months following the completion of an Examination. The Farmee shall respond in writing to any Claim within six (6) months of receipt of such Claim. Upon resolution of a Claim the Farmee shall amend the Financial Records as required to reflect the resolution of the Claim. To the extent that the Parties are unable to resolve any outstanding Claim disclosed by an Examination such Claim shall be resolved by mediation provided that at any time during or within thirty (30) days of the conclusion or termination of the mediation efforts any Party involved in the audit exception may elect by notice to the other Parties involved to have such audit exception resolved pursuant to the Arbitration Act of the Province of Alberta (RSA 1991 c 43.1) as amended from time to time.

Optional Clause 7.06 shall not _____/shall _____ (Specify) be included herein.

7.06 Discrepancies Causing Farmee To Pay For Audit

Notwithstanding Clause 7.04 (Examination Of Records) if the Claim, upon resolution, cause changes to the Financial Records which:

- (i) if Payout has not been achieved for the Test Well, reduce the amount of money remaining to achieve Payout by more than ____% of the amount calculated by the Farmee to achieve Payout as of the date that well first commences production of Petroleum Substances or*
- (ii) if Payout has been achieved for the Test Well, change the date upon which Payout is achieved by more than ____ months*

the Farmee shall pay to the Farmor immediately upon receipt of an invoice for same the reasonable cost of the Examination to which the Claim relates

VIII LAND MAINTENANCE COSTS

8.01 Farmor To Pay Initially During Earning Phase

For the period between the Effective Date and the date the Farmee earns a Working Interest in the Farmout Lands pursuant to the Agreement or the Farmee's right to so earn is terminated as applicable the Farmor shall initially pay:

Clause 8 02

- (i) Determining the traditional per diem reimbursement can be administratively burdensome. For most farmouts it is easier to specify an absolute dollar amount based on an approximation of rentals attributable for the expected earning period which is the concept reflected in Clause 8 02. While not as precise as the traditional per diem method it offers simplicity.
- (ii) Where a large amount of land is subject to the farmout agreement with multiple options the expected earning period can be difficult to estimate. The Farmor would wish to be compensated for the full time the lands could be tied up. On the other hand the Farmee knows that it may not find anything to justify electing Option Wells so it would not wish to pay the maximum rental amount. In that case it may be advisable to revert to the per diem method.

Clause 9 01

- (i) This Abandonment Article applies to the Test Well until the Farmee has unconditionally earned pursuant to the Agreement. Therefore if the Farmee earns by production testing and Capping the Test Well and later decides to Abandon that Test Well this Article would apply rather than the corresponding Article in the Royalty Procedure. Whether the Farmee is Abandoning the well to conditionally earn or Abandoning the well to remove conditions subsequent to earning the Farmee is still conducting earning operations. Therefore it seemed appropriate that the Farmout Procedure Abandonment Article apply in both instances.
- (ii) If the Farmee Completes the Test Well it would have earned unconditionally pursuant to Clause 3 01 of the Agreement. Therefore a subsequent Abandonment would be subject to the Royalty Procedure or the Operating Procedure depending on the status of or elections upon Payout.

Clause 9 02

- (i) Note the reference to attempt to Complete. Should the Farmor not have the right to take over the well for another purpose (e.g. water disposal)? The authors believed that as the original purpose of this well was exploratory (i.e. to evaluate the Farmout Lands) the Farmor's right to take over should be restricted to purposes higher than mere water disposal. Completion in reserved formations however was considered appropriate. Note that different rules apply to Royalty Wells which will apply to the Test Well if the Farmee has already unconditionally earned the Farmout Lands.
- (ii) The 24 hour and 15 day periods referenced in this Clause only commence if the Farmee has forwarded the information it is required to forward to the Farmor. Therefore the Farmee should ensure that information is delivered promptly.

- (i) rentals required pursuant to the Regulations or the Title Documents to maintain the Farmout Lands in good standing and
- (ii) annual payments in lieu of lessor royalty with respect to suspended wells located on lands included in the Title Documents which payments are required pursuant to those Title Documents to maintain the Farmout Lands in good standing

provided that nothing in this Clause shall obligate the Farmor to pay any compensatory royalties

8.02 Farmee To Reimburse Farmor

The Farmee shall pay the Farmor the amount of _____ within sixty (60) days of the last day of the calendar month in which falls the Effective Date. This amount shall be deemed to represent full reimbursement of rentals and the annual payments in lieu of royalty paid and referenced in the immediately preceding Clause attributable to the Title Documents from the Effective Date to the date the Farmee earns an interest therein or the date the Farmee's right to earn an interest therein terminates whichever is applicable.

IX. ABANDONMENT OF TEST WELL

9.01 Application Of Abandonment Article

This Article shall apply to the Test Well if the Farmee

- (i) intends to earn a Working Interest in the Farmout Lands pursuant to the Agreement by Abandoning the Test Well or
- (ii) has conditionally earned a Working Interest in the Farmout Lands pursuant to the Agreement by Capping the Test Well and the Farmee intends to remove the conditions on earning by Abandoning the Test Well

If the Farmee has unconditionally earned a Working Interest in the Farmout Lands pursuant to the Agreement, the Royalty Procedure or the Operating Procedure as applicable shall apply to the Abandonment of the Test Well.

9.02 Farmor's Right To Take Over Well

If the Farmee drills the Test Well to Contract Depth and has performed all related obligations hereunder and under the Agreement to the Farmor's reasonable satisfaction, the Farmee may give notice of its intention to Abandon the Test Well to the Farmor. The Farmee shall supply the Farmor with all information the Farmee is obligated to provide the Farmor concerning that well and such other data for that well which may be reasonably required by the Farmor in determining whether it wishes to exercise its right pursuant to this Article. Within twenty-four (24) hours of receipt of the Farmee's notice and such information where a drilling rig capable of conducting the Abandonment is on location and within fifteen (15) days of receipt of the Farmee's notice and information in all other cases, the Farmor may elect by notice to the Farmee to have further tests conducted on the well or to take over and attempt to Complete the well.

If the Farmor elects to have further tests conducted on the well and the Farmee reasonably believes that the condition of the wellbore permits, the Farmee shall conduct the tests specified in the notice in a timely manner on behalf of and at the sole cost, risk and expense of the Farmor. If the Farmee reasonably believes the condition of the wellbore does not permit the conduct of these additional tests, it shall give notice of same to the Farmor immediately.

Within twenty-four hours of receipt by the Farmor of that notice or the information from those additional tests as applicable where a drilling rig capable of conducting the Abandonment is on location and within fifteen (15) days of receipt of that notice or additional test information in all other cases, the Farmor may elect by notice to the Farmee to take over and attempt to Complete the well.

Clause 9 03 The assignment of the well and relevant surface rights is triggered by the Farmor's election. In contrast pursuant to Clause 9 05 the assignment of the Spacing Unit for the Completed zone requires the Farmor to successfully Complete that zone.

Clause 9 04

- (i) Once the Farmor takes over the well it should conduct its operations in a timely manner to avoid dissatisfaction on the part of regulatory authorities and surface lessors. By setting a definite time period the Farmor has greater comfort that the Test Well will be dealt with.
- (ii) The time period inserted should be reasonable for the area. What sort of access is there for this area?
- (iii) If the Farmor takes over the well but the Completion attempt is unsuccessful the Farmor may Abandon the Test Well for the Farmee's account if Abandonment commences within the inserted time period. After that period the two Alternates give the Parties a choice as to how accounts should be settled the difference being the netting of Abandonment costs. The rationale for Alternate A is that the Farmee was prepared to Abandon the well anyway. By including expected Abandonment costs the Farmee is in no worse position than if it proceeded with the Abandonment. The rationale for Alternate B is that the Farmee should not be responsible to pay for an Abandonment that may not occur especially since the Farmor at the stage when these accounts are being settled has not complied with the first sentence of this Clause. The Parties must decide which philosophy to apply. The authors see merit in both.

Clause 9 05 For a successful Completion the Farmor is entitled to the Spacing Unit in the Completed zone. This entitlement will not apply if the Farmor fails to Complete the well in the time period specified in the first sentence of Clause 9 04 or if the Farmor Completes a Reserved Formation. The Farmee must be freed of uncertainty at some point as to the zones it has earned.

Failure by the Farmor to give notice within the applicable election periods set forth in this Clause shall be deemed to be the Farmor's concurrence with the Abandonment of that well. The Farmee shall Abandon that well unless the Farmor elects to take over that well pursuant to this Clause.

9.03 **Surface Rights And Equipment**

If the Farmor takes over a well pursuant to this Article, the Farmee shall, effective as of the date of the Farmor's election to take over that well, assign that well (including the material equipment and surface access rights relating thereto which the Farmor wishes to utilize) to the Farmor without warranty. The Farmee shall be released from all obligations and liabilities accruing for the property assigned to the Farmor pursuant to this Clause following the assignment. That assignment shall not release the Farmee from any obligation which should have been performed by it or any liability which may have accrued to it prior to that assignment.

9.04 **Well May Be Abandoned For Account Of Farmee**

If the Farmor takes over a well pursuant to this Article, the Farmor shall Complete or commence to Abandon the well within _____ months of the date of the Farmor's election to take over that well.

If the Farmor does not Complete but commences to Abandon the well within the time period referenced in the first sentence of this Clause, the Farmor shall Abandon that well for the account of the Farmee, provided that the Farmee shall not be responsible for any extra costs of Abandonment resulting from the Farmor's takeover of that well. The Farmee shall pay the Abandonment costs for which the Farmee is responsible under this Clause within thirty (30) days of being invoiced for same by the Farmor.

If the Farmor does not either Complete or commence to Abandon the well within the time period referenced in the first sentence of this Clause, ALTERNATE _____ (Specify A or B) shall apply.

ALTERNATE A.

The Farmee shall calculate the estimated net salvage value of the material and equipment assigned to the Farmor and the costs and expenses to Abandon that well, excluding therefrom any extra costs which might be incurred as a result of operations conducted thereon by or on behalf of the Farmor. The estimated Abandonment costs and the estimated net salvage value of the material and equipment assigned to the Farmor shall be offset. The resultant payor shall pay the payee the amount so calculated or determined within thirty (30) days of receiving an invoice for same.

ALTERNATE B

The Farmee shall calculate the estimated net salvage value of the material and equipment assigned to the Farmor. The Farmor shall pay the amount calculated within thirty (30) days of receiving an invoice for same. The Farmee shall cease to be responsible for Abandonment costs.

If the Parties are unable to agree on cost or value estimates, the applicable costs or values shall be determined by mediation, provided that at any time during or within thirty (30) days of the conclusion or termination of the mediation efforts, any Party involved in the dispute may elect by notice to the other Parties involved in the dispute to have such costs or values determined pursuant to the Arbitration Act of the Province of Alberta (RSA 1991 c. 43.1) as amended from time to time. The resultant payor shall pay the payee the amount so determined within thirty (30) days of that determination.

9.05 **Effect On Farmee's Interest**

If within the time period specified in the first sentence of the preceding Clause, the Farmor Completes the well in zones originally contained in the Farmout Lands, the Farmee shall assign to the Farmor, without warranty, the Farmor's Working Interest in the Spacing Unit for that well in the zone Completed by the Farmor and the Petroleum Substances therein, effective as of the date of the Farmor's election to take over that well. That assignment shall not release the Farmee from any obligation which should have been

Clauses 9 06 This Clause would be used where there are multiple Farmor Parties

Clause 10 01

- (i) Note the distinct treatment between liability and indemnity. If the distinction between the two is blurred, the Farmor faces the risk that the provision could be held to be solely an obligation to indemnify. In such event, the Farmor would not be able to rely on the Clause to provide it with a remedy with respect to direct damage to the Farmor's property.
- (ii) The Farmor would still be required to prove its damages.

performed by it or any liability which may have accrued to it prior to that assignment. Either the Farmor or the Farmee may initiate transfer documentation to cause the interests to be transferred to the Farmor pursuant to this Clause. After initiation by either Party of such exchange of documentation, each of the Farmor and the Farmee shall be obligated to use all reasonable efforts to sign and deliver whatever transfers may be obtainable for those interests.

If the Farmor does not Complete the well in zones originally contained in the Farmout Lands within the time period specified in the first sentence of the preceding Clause or if the Farmor Completes the well in a Reserved Formation within that time period whichever first occurs this Clause shall cease to apply.

Optional Clause 9.06 shall not _____/shall _____ (Specify) be included herein.

9.06 Operating Procedure Applies Among Farmors

If one or more (but fewer than all) of the Farmor Parties elect to conduct additional tests for a well proposed to be Abandoned pursuant to this Article those of the Farmor Parties which do not elect to participate in such tests shall not be entitled to participate in the takeover and Completion of the well in the tested zone. If one or more (but fewer than all) of the Farmor Parties elect to take over a well proposed to be Abandoned pursuant to this Article that takeover shall be at the sole cost and expense of the Party or Parties taking over the well, shall be deemed to be an independent operation under the Operating Procedure and shall be subject to Article X (LIABILITY AND INDEMNITY) mutatis mutandis as between (i) the Party or Parties so taking over the well and (ii) the Party or Parties comprising the Farmor which elect not to take over such well. In such event the amount (if any) paid to the Farmee pursuant to Clause 9.04 (Well May Be Abandoned For Account Of Farmee) shall be deemed to be an operating cost (as defined in the Operating Procedure) for the purposes of determining the amount of the penalty applicable to the takeover and completion.

From and after the effective date referred to in Clause 9.05 (Effect On Farmee's Interest) the Operating Procedure shall apply mutatis mutandis as among the Parties comprising the Farmor to the well assigned by the Farmee and to those lands and Petroleum Substances assigned by the Farmee by virtue of that Clause. Those Farmor Parties shall appoint one of them to be the initial Operator under the Operating Procedure. If no schedule entitled Operating Procedure is attached to the Agreement, the term Operating Procedure for the purpose of this Article shall mean the 1990 Canadian Association of Petroleum Landmen form of operating procedure and as an attachment thereto the 1988 (February 1991 revision) Petroleum Accountants Society of Canada form of accounting procedure with rates and elections the affected Parties may negotiate at the required time.

X. LIABILITY AND INDEMNITY

10.01 Farmee's Responsibility

The Farmee shall

- (a) be liable to the Farmor for all losses, costs, damages and expenses whatsoever (whether contractual or tortious) which the Farmor may suffer, sustain, pay or incur; and
- (b) in addition, indemnify and hold harmless the Farmor and its directors, officers, agents and employees against all actions, causes of action, proceedings, claims, demands, losses, costs, damages and expenses whatsoever which may be brought against or suffered by the Farmor, its directors, officers, agents and employees or which they may sustain, pay or incur.

insofar as they are either a direct result of any act or omission (whether negligent or otherwise) of the Farmee with respect to operations or activities conducted by it or on behalf of it provided that the Farmee shall not be liable to or be required to indemnify and hold harmless the Farmor and its directors, officers, agents and employees to the extent that the particular act or omission was done or was omitted to be done in accordance with the instructions of or the concurrence of the Farmor.

Clause 10.02 The principal operations conducted by the Farmor hereunder would be well takeovers at Abandonment and operations with respect to Reserved Formations

Clause 12.01

- (i) The first sentence refers to failure Spud on time (for reasons other than Force Majeure) The Farmor may terminate the Agreement No 30 day period to remedy applies
- (ii) If the Farmee is prevented by Force Majeure from Spudding an earning well either the Farmee or the Farmor may decide to cut their losses and bring the earning phase of the Farmout Agreement to an end This will prevent farmout agreements from being held in limbo due to Force Majeure for unreasonable lengths of time
- (iii) For other forms of default the 30 day period applies but there is a difference between being in default for a condition subsequent to earning and all other forms of default For the former the Farmee could lose all its conditionally earned interest For the latter there is a restriction protecting interests already earned by the Farmee

10.02 Farmor's Responsibility

Where the Farmor conducts operations or activities with respect to the Farmout Lands, the provisions of the preceding Clause shall apply mutatis mutandis to determine the Farmor's responsibility to the Farmee with respect to losses attributable to such operations or activities.

XI. ASSIGNMENT

11.01 Permitted Assignments - Earning Phase

During the period that the Farmee has a right to earn an interest in the Farmout Lands and if applicable the Option Lands pursuant to the Agreement, it shall not dispose of any portion of its interest, other than an assignment made by way of security of indebtedness or to an Affiliate without the written consent of the remaining Parties which consent shall not be unreasonably withheld. If the Farmee assigns an interest such that the Farmee comprises more than one Party, Clause 1.10 (Multiple Farmee Parties) shall apply and those Farmee Parties shall designate one of them to be the Managing Farmee. If the Farmor assigns an interest such that the Farmor comprises more than one Party, Clause 1.11 (Multiple Farmor Parties) shall apply.

XII. DEFAULT

12.01 Farmor's Remedies In The Event Of Default

If the Farmee fails to Spud the Test Well by the date required in the Agreement and Article XIII (FORCE MAJEURE) is not applicable to that failure to so Spud the Test Well, the Farmor may at any time prior to the Farmee Spudding that well give notice to the Farmee terminating the Agreement. If Article XIII (FORCE MAJEURE) other than Clause 13.05 (Surface Access Difficulties) applies to the Farmee's failure to Spud the Test Well and if the Farmee's obligation to Spud the Test Well has been suspended for more than six months, either the Farmor or the Farmee may give notice one to the other terminating the Agreement. To the extent the Farmee had conducted operations prior to the Force Majeure, the Farmee shall Abandon the well site and access roads.

If the Farmee makes any default in any of its obligations hereunder or under the Agreement other than the failure to Spud the Test Well by the required date and subject to Article XIII (FORCE MAJEURE), the Farmor may give the Farmee notice stating the nature of that default. If the Farmee fails to commence to remedy that default within thirty (30) days after receipt of such notice or fails to continue to remedy that default with all due diligence thereafter, the Farmor may by notice to the Farmee terminate all or any portion of the interest of the Farmee acquired in the Farmout Lands pursuant to this Farmout Agreement.

If the default is not with respect to conditions subsequent to the Farmee's earning in the Farmout Lands, no such termination shall apply to any portion of the Title Documents in which the Farmee had earned a Working Interest pursuant to the Agreement prior to the default.

Nothing in this Article shall release the Farmee from any obligation to indemnify or to be liable to the Farmor to pay any amount owing to the Farmor pursuant to this Farmout Agreement to maintain information confidential or if applicable to finish Abandoning the Test Well.

12.02 Article Does Not Affect Rights At Law

The rights hereby granted to the Farmor shall be in addition to and not in substitution for any other right or remedy which the Farmor may have hereunder or under the Agreement and specifically the existence or the exercise of those rights shall not deprive the Farmor either wholly or partially of any other right or remedy at law or in equity including damages and indemnity.

Clause 12.03

- (i) Interest should accrue whether or not the Farmor has given the Farmee prior notice of an intention to charge interest. The inclusion of the regardless phrase should eliminate the risk that prior notice is required as was held in Renaissance Resources Ltd v Metalore Resources Ltd, [1984] 4 W R R 430 (Alta Q B) affirmed [1985] 4 W W R 673 (Alta C A.)
- (ii) The reference to the Regulations is required because of the provisions of the Interest Act and comparable legislation
- (iii) The second last sentence recognizes that more than one bank rate may apply if there are multiple Farmor Parties

12.03 Right To Charge Interest For Financial Default

If the Farmee fails to pay or advance within the time period prescribed any amount the Farmee is obligated to pay as provided hereunder or under the Agreement, the Farmor may without limiting the Farmor's other rights as contained hereunder or under the Agreement or otherwise held at law or in equity charge the Farmee compound interest, calculated and accrued monthly with respect to that unpaid amount from the day such payment is due until the day it is paid at the rate of two percent (2%) per annum higher than the rate designated as the prevailing prime rate for Canadian commercial loans by the principal chartered bank used by the Farmor regardless of whether the Farmor has notified the Farmee in advance of its intention to charge interest with respect to that unpaid amount. The obligation to pay interest is to apply until such default is rectified and shall not merge into a judgement for principal and interest, or either of them. The Farmee waives the application of any Regulations to the contrary insofar as such waiver is permitted by the Regulations. If there are multiple Farmor Parties this Clause shall apply to each Farmor Party. If the Farmor fails to pay within the time period prescribed any amount that the Farmor is obligated to pay hereunder or under the Agreement this Clause shall apply except that references to the Farmee shall be read as Farmor and vice versa.

XIII FORCE MAJEURE

13.01 Definition Of Force Majeure

In this Article Force Majeure means an occurrence beyond the reasonable control of the Party claiming suspension of an obligation hereunder or under the Agreement which has not been caused by such Party's negligence and which such Party was unable to prevent or provide against by the exercise of reasonable diligence at a reasonable cost and includes without limiting the generality of the foregoing an act of God war revolution insurrection blockade riot strike a lockout or other industrial disturbance fire lightning, unusually severe weather storms floods explosion accident shortage of labour or materials or government restraint action delay or inaction.

13.02 Suspension Of Obligations Due To Force Majeure

If any Party is prevented by Force Majeure from fulfilling any obligation hereunder or under the Agreement the obligation so affected shall be suspended while the Force Majeure continues to prevent the performance of such obligation and for that time thereafter as that Party may reasonably require to commence to fulfil such obligation. A Party prevented from fulfilling any obligation by Force Majeure shall promptly give the other Parties notice of the Force Majeure and the affected obligations including reasonably full particulars thereof.

13.03 Obligation To Remedy

The Party claiming suspension of an obligation by reason of Force Majeure shall promptly use all reasonable efforts to remedy the cause and effect of the applicable Force Majeure and such Party shall promptly give the other Parties notice when the Force Majeure ceases to prevent the performance of the applicable obligation. The terms of settlement of any strike lockout or other industrial disturbance shall be wholly in the discretion of that Party and that Party shall not be required to accede to the demands of its opponents in any strike lockout or industrial disturbance solely to remedy promptly the event of Force Majeure.

13.04 No Exception For Lack Of Finances

Lack of finances shall not be considered an event of Force Majeure nor shall any Force Majeure suspend any obligation for the payment of money due hereunder or under the Agreement.

13.05 Surface Access Difficulties

Notwithstanding any provision to the contrary contained in the Agreement or the Farmout Procedure to the extent that surface conditions do not enable the Farmee to have access to the Farmout Lands within the time period specified for the commencement and/or completion of an operation the Farmee shall give

Article XIV It may be advisable to add a sunset provision for seismic information which does not go into the public domain. The time of sunset could be a certain number of years after the Title Documents earned under the Agreement expire. A similar sunset provision could be added to the Operating Procedure. The reason for this sort of sunset is to prevent being bound by a confidentiality clause for old information. The administrative inconvenience of getting consents could well outweigh the value of trading the information.

notice of same to the Farmor. If the Farmor consents, which consent shall not be unreasonably withheld, that operation may be postponed until such time as surface conditions permit access to the location of such operation, at which time the Farmee shall move the requisite equipment thereto in a timely manner.

XIV CONFIDENTIAL INFORMATION

14.01 Confidentiality Requirement

Each Party entitled to information obtained hereunder or under the Agreement may use such information for its sole benefit. The Parties shall take such measures with respect to operations and internal security as appropriate in the circumstances to keep confidential from third persons all such information except information which the Parties have expressly agreed among themselves to release and information disclosed by a Party:

- (a) when and to the extent required by the Regulations and securities laws applicable to such Party provided that such Party shall invoke any confidentiality protection permitted by such Regulations and securities laws;
- (b) to an Affiliate provided that such Party shall be deemed to have required such Affiliate to maintain the confidential status of the disclosed information and that such Affiliate shall be deemed to have accepted such obligation and that such Party shall be liable for any loss suffered by the Parties or any of them because of the failure of such Affiliate to maintain such information confidential;
- (c) to a third person to which such Party has been permitted to assign a portion of its interest hereunder provided that a binding covenant is obtained from such third person prior to disclosure which provides inter alia that none of such information shall be disclosed by it to any other third person;
- (d) to the technical, financial or other professional consultants of such Party which require such information to provide their services to such Party or to a bank or other financial institution from which such Party is attempting to obtain financing provided that a binding covenant is obtained from such consultant or financier as the case may be prior to such disclosure which provides inter alia that none of such information shall be disclosed by it to any other third person or used for any purposes other than advising such Party or providing financing to such Party as the case may be; and
- (e) as and when required to any recognized association within the petroleum industry of which such Party is a member that engages in the exchange of factual information relating to the type of operations conducted pursuant to this Agreement, unless and to the extent that the information pertains to a well which a Party has requested to be given tight hole status provided that such Party shall invoke any confidentiality protection permitted by such association with respect to such disclosed information.

The confidentiality obligation in this Clause shall not extend to information to the extent it is in the public domain provided that specific items of information shall not be considered to be in the public domain merely because such items are embraced by more general information in the public domain.

14.02 Confidentiality Requirement To Continue

Any Party which otherwise ceases to be bound by the provisions of this Farmout Procedure or the Agreement shall remain bound by the provisions of this Article with respect to information obtained hereunder or under the Agreement until and to the extent that such information is in the public domain.

XV NOTICE

15.01 Service Of Notices

Whether or not so stipulated hereunder or under the Agreement all notices, communications and statements (herein called "notices") required or permitted hereunder or under the Agreement shall be in writing. Any notice to be given hereunder or under the Agreement shall be deemed to be served properly if served in any of the following modes.

- (a) personally by delivering the notice to the Party on whom it is to be served at that Party's address for service which notices shall be deemed received by the addressee when actually delivered as aforesaid if such delivery is during normal business hours; provided that if a notice is not delivered during normal business hours, such notice shall be deemed to have been received by such Party at the commencement of the day next following the date of delivery other than a Saturday, Sunday or statutory holiday; or
- (b) by telefacsimile (or by any other like method by which a written and recorded message may be sent) directed to the Party on whom it is to be served at that Party's address for service which notice shall be deemed received by the respective addressee thereof: (i) when actually received by it, if received within normal business hours; or (ii) at the commencement of the next ensuing business day following transmission thereof if such notice is not received during such normal business hours; or
- (c) by mailing it first class (air mail if to or from a location outside Canada) registered post postage prepaid directed to the Party on whom it is to be served at that Party's address for service which notices shall be deemed to be received by the addressee at noon local time on the earlier of the actual date of receipt or the fourth (4th) day (excluding Saturdays, Sundays and statutory holidays) following the mailing thereof; provided that if postal service is interrupted or operating with unusual or imminent delay, notice shall not be served by such means during such interruption or period of delay.

For periods of forty-eight (48) hours or less the applicable notice shall be given in accordance with Subclause (a) or (b) of this Clause provided that notices of twenty-four (24) hours or less may be made by telephone and shall be deemed to be received at the conclusion of the conversation if the telephone conversation is between representatives of the Parties who are specifically authorized to accept that notice; those representatives are officially in duty at the time of that conversation; and that telephone conversation and notice are then confirmed pursuant to Subclause (a) or (b) of this Clause.

15.02 Addresses For Notices

The address for service of notices of each of the Parties shall be as follows:

15 03 Right To Change Address

Any Party may change its address for service by notice to the other Parties and that changed address for service thereafter shall be effective for all purposes of this Farmout Procedure and the Agreement

XVI MISCELLANEOUS

16 01 Perpetuities

The right of any Party to acquire any interest in lands subject to the Agreement or the Farmout Procedure shall not extend beyond the period set out in the applicable perpetuities Regulations and where no such legislation is in effect, it shall not extend beyond 21 years after the lifetime of the last survivor of the lawful descendants now living of Her Majesty Queen Elizabeth II.

16 02 Supersedes Earlier Agreements

Except for the Operating Procedure and the Royalty Procedure if applicable and this Farmout Procedure the Agreement supersedes all other oral or written agreements documents memoranda written and verbal understandings among the Parties relating to the Farmout Lands and expresses all of the terms and conditions agreed upon by the Parties with respect to the Farmout Lands

16 03 Time Of Essence

Time is of the essence in the Agreement and this Farmout Procedure

16 04 No Partnership

Nothing contained in the Agreement or this Farmout Procedure shall be construed as creating a partnership or similar association

16 05 No Amendment Except In Writing

Except as otherwise provided in the Agreement or the Farmout Procedure no amendment or variation of the provisions of same shall be binding upon any Party unless and until it is evidenced in writing executed by the Parties

16 06 Binds Successor And Assigns

Subject to Article XI (ASSIGNMENT) the Agreement and the Farmout Procedure shall enure to the benefit of and shall bind the Parties their respective successors and assigns and the heirs executors administrators and assigns of natural persons who are or become Parties

16 07 Laws Of Jurisdiction To Apply

The Agreement and the Farmout Procedure shall be interpreted according to the laws of the jurisdiction within which the Farmout Lands are situated and the laws of Canada applicable therein. The courts having jurisdiction with respect to matters relating to the Agreement or the Farmout Procedure shall be the courts of that jurisdiction

16 08 Use Of Name

A Party shall not use or permit to be used the name of any other Party either directly or indirectly in connection with the financing in whole or in part of any operation on the Farmout Lands or in connection with the offering for sale of shares of stock or any other securities or the promotion or formation of any enterprise of any kind without in each instance first obtaining the written consent of such Party

16.09 Waiver

No waiver by any Party of any breach (whether actual or anticipated) of any of the covenants, provisions, conditions, restrictions or stipulations contained herein or in the Agreement shall take effect or be binding upon that Party unless the same is expressed in writing under the authority of that Party. Any waiver so given shall extend only to the particular breach so waived and shall not limit or affect any rights with respect to any other or future breach.

16.10 Further Assurances

Each of the Parties shall from time to time and at all times do all such further acts and execute and deliver all such further deeds and documents as shall be reasonably required in order to fully perform and carry out the terms of the Agreement or the Farmout Procedure.