

**OVERVIEW OF UPDATE
2015 CAPL FARMOUT & ROYALTY PROCEDURE**

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DESIRED OUTCOMES FROM TODAY'S PRESENTATION

- An understanding of:
 - Why the update was done and the document objectives.
 - What the major changes are.
- Your belief that becoming familiar with the document offers significant positive near-term payoffs.
 - Your company.
 - You personally.
- A greater sense of comfort as you review the materials.
 - The thought that went into them.
 - The responsiveness to comments.
 - A sense that we've tried to "do the right thing".
 - Addressed reasonably foreseeable issues with solutions that you believe are reasonable.

CONTEXT

- Common themes in all Industry document standardization initiatives.
 - Position users to negotiate, document and administer agreements more efficiently and effectively and to mitigate the potential for unnecessary disputes to disrupt or damage ongoing relationships.
 - Enable users of all experience levels to enhance their expertise and ability to contribute to the value creation process.
- But certain inherent “inconvenient truths” that are, well, inconvenient.
 - Agreements must reflect the needs of the business, not the reverse.
 - Major changes in the business over the last 15+ years.
 - Emphasis on Hz Wells, the “shale revolution” and, most recently, the use of long-reach Hz Wells and multi-well drilling pads.
 - The CAPL documents of the 1990s required major modifications to address the needs of the business of today and tomorrow.
 - The 2007 CAPL Operating Procedure has “happened”, as will the 2015 update to that document and this update to the 1997 CAPL Farmout & Royalty Procedure.
 - Change is not pleasant, but does offer an opportunity.

WHY?

The 1997 CAPL Farmout & Royalty Procedure and 1997 CAPL Overriding Royalty Procedure have generally held up well, so why change them?

- A major update was required because of:
 - Opportunities identified by Industry's experiences.
 - Fewer calls than on the CAPL Operating Procedure.
 - Evolving business needs.
 - Hz wells and related ORR allocations, the "shale revolution", increased drilling density, Re-entry Programs, partial WI farmouts, larger scale transactions.
 - Changing legal and regulatory landscape.
 - Very few cases involving the 1997 documents.
 - Need to apply "plainer language" principles to simplify the document and reflect a more modern drafting style.
- The challenge was to meet the needs of today and to anticipate the needs of tomorrow in a way in which industry uses the end product.
 - Evolution from an early stage "Blackberry" to a "Smart Phone".
 - Much greater functionality, while remaining intuitive.

WHO?

A cross-section of industry stakeholders directly represented on the Committee, to reflect that the document is an industry document, not just a “land document”.

- “CAPL”-Jim O’Byrne, Carolanne DeBiasio, Dennis Eisner, Lawrence Fisher, Ken Gummo, Helen Klein, John Miele, Mike Ponto, Glen Sveinson, Jim MacLean
- CAPLA Liaison-Lynn Gregory
- CAPPa Liaison-Al Roemer
- EPAC Liaison-Dave Savage
- Legal Liaison-Mike Thackray
- PASC Liaisons-Larry Yasman (Joint Interest Research), Kirsten Strieck (Audit)
- PJVA Liaison-Paul de Villenfagne
- Other functional linkages as required over the course of the project.

WHEN?

- Initial work was put on hold in 2009 because of the slow transition to the 2007 CAPL Operating Procedure.
- Initial industry draft issued in June, 2014; 2nd draft March; 3rd draft June; and two iterations with commenting parties in October.
- A desire to “listen, learn, act” by trying to build engagement through transparency and responsiveness to comments.
 - Materials made available through CAPL’s web page over the course of the project to optimize accessibility.
 - Matrix showing all material changes and rationale for change.
 - Comment matrix with verbatim comments and our responses.
 - Company codes used, as with Operating Procedure.
 - Used 80%+ of comments in some way to enhance the quality of the document significantly.
 - Emphasis on awareness and education over the project.
- Completed project in time for the next drilling season.
 - 1997 document creation process was 13 months and the document was widely used during the 1997-1998 winter drilling season.
- Trying to facilitate a timely and orderly transition for collective benefit.

“REPORT CARD” ON DRAFTS

- Feedback on the drafts was more limited than expected.
 - Seven larger companies submitted comments on the final draft that were very helpful in optimizing the final documents.
 - The document was typically modified to address comments received over the course of the project, with detailed responses and the sharing of working drafts with the commenting parties during the late stages of the project to confirm alignment.
 - Informal feedback from others was also otherwise very positive.
 - Documents also edited aggressively during the updates to the drafts.
- From a commenting company not otherwise involved in the project on the initial, much less polished 2014 draft:
 - *“After reviewing the document with the ... team we noticed a constant theme. This agreement is predominately providing context and clarity on almost all clauses compared to the 1997 FO and Royalty Procedure. This context and clarity are welcomed as this document is addressing current situations that the industry is facing with the focus on resource plays, technology and horizontal drilling.”*
- Very positive survey data from Feb., 2015 CAPLA lunch presentation.

MAJOR DOCUMENT OBJECTIVES

1. Make required modifications, while maintaining the integrity and substance of the 1997 document.
 - Provide a new and improved “car manual” that provides users with clear and complete answers to their questions.
 - Offer reasonable responses to reasonably foreseeable issues.
 - Also complete update to 1997 CAPL Overriding Royalty Procedure.
2. Create a document that will be used widely soon after completion.
 - Balance needs of Farmors and Farmees, large and small users.
 - Emphasis on awareness and education during the project.
 - Extensive use of annotations that can help users of all experience levels with new and older transactions immediately.
3. Minimize administrative effort associated with earning arrangements.
 - Additional functionality to simplify Head Agreements.
 - See the sample agreements in the Addendums.
4. Align document with evolving business needs.
 - Hz Wells and related ORR allocations, “shale revolution”, multi-zone targets, increased drilling densities, large deals, Re-entry Programs.
5. Simplification.
6. Structure document to exploit advances in systems technology.

MAJOR CHANGES

Length

The first thing you will notice about the document is that it is materially longer than the 1997 document.

- Was a sensitivity to length in 1997 document to encourage acceptance.
- Inclusion of headings for every Subclause for ease of use.
- Splitting up longer provisions for ease of use.
 - Clauses into Subclauses, presentation of concepts in a list format.
- Expansion of existing provisions to address recognized issues.
 - Such as 1.02, 3.01, 3.02, 5.05, 6.02, 6.06, 8.01, 9.03.
- New provisions to address reasonably foreseeable issues.
 - Definitions-Additional 9 definitions (1 page).
 - Modifications supporting Re-entry Programs (.5 page).
 - 3.03B&C-Trust duties to mitigate need for trust ag'ts (.8 page).
 - 5.03-ORR for Hz wells straddling Royalty Lands (2 pages).
 - 10.00-Partial interest farmouts and Existing Ag'ts (2 pages).
 - 18.00-Restriction on extra drilling & Title Administrator (.5 page).

The net effect is that users have much clearer answers on their issues.

MAJOR CHANGES

Simplification And Format

- Aggressive editing.
 - Use of “plainer language” without sacrificing content.
 - Breakdown of provisions into Subclauses and list formats.
- Inclusion of headings for each Subclause and several words of context for the vast majority of cross-references.
- Offer greater functionality to facilitate completion of agreements.
 - Test Well Programs, partial interest farmins, Re-entry deals.
 - Horizontal Well functionality and annotations.
 - Designed for more typical transactions, with users expected to modify document to address special circumstances.
 - Inclusion of special related annotations to assist users in recognizing issues for which modifications may be appropriate.
- Expanded annotations significantly.
 - Information on evolution of Clauses as a reference tool when considering issues under older and current agreements.
 - Detailed review of relevant cases.
 - Inclusion of other ideas that might be considered in new transactions.

MAJOR CHANGES

Article 1.00-Definitions And Interpretation

- New def'ns of: Existing Agreement; Option Well Program; ORR Conversion Date; Pre-Earning Working Interest; Re-entry Program; Re-entry Program Costs; ROFR; Test Well Program; Volume Recovery.
- Clause 1.02: Aligned to 2015 CAPL Operating Procedure, with a number of modifications for this document.
 - Parallel project to update to a 2015 CAPL Operating Procedure.
 - Mostly to address shale projects and long-reach Hz Wells.
 - Also address intervening case law and learnings on 2007 CAPL.
 - Specific modifications that are not expected to be contentious.
- Clause 1.04: Added Paragraph (e) to provide safeguard for Farmee Parties that do not create a side agreement to govern their activities.

Article 2.00-Title And Encumbrances

- Clause 2.01: New Clause provides a right to do a title review.
- Clause 2.04: New Clause to address obligation to comply with any consent or ROFR requirements respecting a partial interest farmout.

MAJOR CHANGES

Article 3.00-Test Well

- Area of biggest learnings respecting 1997 document, particularly in the context of when the Farmee's obligations are complete.
- Extensive rework of the Article-5 pages vs 1.25 pages.
- New Subclause 3.01B for difficulties in commencing operations.
 - Addresses major deficiencies with the typical industry handling.
 - Note: Users might consider using immediately.
- Much greater clarity about the interrelationship between "Complete, Cap and Abandon", the obligation to evaluate the Test Well to the Farmor's reasonable satisfaction and zonal testing requirements.
- Paragraph 3.01D(a): Farmee to Abandon a well that produces <60 days.
- Inclusion of optional Paragraph 3.01D(b) for Hz Well evaluations.
- Inclusion of optional Paragraph 3.01D(d) to address finality of the Farmee's well evaluation obligations.
- Clause 3.02: Major modifications after learnings from a real example.
- Subclauses 3.03B&C: Inclusion of trust duties to attempt to minimize need for trust agreements.
- Subclause 3.03D: Optional Subclause to prohibit Capping for earning.

MAJOR CHANGES

Article 5.00-Overriding Royalty

- Extensive annotations about case law and interest in land issue.
- Clause 5.03: New Clause to address Royalty Wells that straddle Royalty Lands and other lands, with Alternates for royalty length approach and application of the Regulations approach (e.g., Sask “cigar” method).
 - Alternate 1 uses an allocation ratio of royalty length/total hz length.
 - Linkages to the As Drilled Survey.
 - Note: Users might consider using immediately.
- Clause 5.05: Modified Subclause 5.05A to offer two Alternates for handling of costs through First Point of Measurement.
 - Alternate 1-Traditional, 1997 type approach.
 - Alternate 2-Royalty Owner generally shares cost for removal, storage and disposal of basic sediment, water and other impurities.
 - Offer functionality within document for high handling costs.
 - Exception for handling of frac water during initial cleanup period.
 - Note: Users might consider using immediately.
- Subclause 5.05C: Introduced a new potential control on deductions-Alternate 3, which is a fixed \$ amount/ 10^3m^3 for natural gas.

MAJOR CHANGES

Article 6.00-Conversion Of Overriding Royalty

- General: Definitions of ORR Conversion Date and Volume Recovery to allow a BPO/APO conversion at traditional Payout or the specified Volume Recovery, as applicable.
 - Delinking of the volume based “Payout” approach in the 1997 document from the traditional financial Payout.
 - Election triggered at earlier of ____ months after drilling rig release or the date in the selected Alternate (Payout or Volume Recovery).
 - To minimize long-standing conversion rights on marginal wells.
- Clause 6.02: New Subclause B clarifying conversion outcomes for an Earning Well proposed for Abandonment.
- Subclause 6.06D: 1997 Clause did not apply to an additional well in the same formation as the productive BPO Earning Well.
 - An important issue because of holdings and other higher density drilling authorizations under the Regulations.
 - Party opting for ORR in the new well waives its conversion right on the BPO Earning Well-to reflect regulator’s common ownership req’t.
 - Note: Users might consider using immediately.

MAJOR CHANGES

Article 7.00-Abandonment Of Wells

- Clause 7.01: Much clearer that the Farmor is permitted to use the Earning Well taken over by it in the Reserved Formations.
- Subclause 7.01D: Protection for the Farmee that the Farmor must be eligible to accept the well licence to take over a well.
- Subclause 7.01E: Assignment is on an “as is where is” basis.
- Clause 7.03: Impact on the Farmee after a takeover that is successful in a zone of Farmout Lands is limited to the well and production therefrom.
 - Similar to changes in the 2007 CAPL Operating Procedure.
 - No land forfeiture in Spacing Unit in the zone.
 - Protection for Farmee if new well in zone or re-entry as Hz well.
 - Reacquisition right if the Farmor wishes to use the well for other operations in the Farmout Lands.
- Clause 7.05: Two Alternates re takeover of other Royalty Wells.
 - Alternate 1-1997 provision.
 - Alternate 2-Takeover right applies to all Royalty Wells.

MAJOR CHANGES

Article 8.00-Area Of Mutual Interest

- Significant expansion of annotations to increase awareness.
 - Legal developments (Chase Manhattan Bank and Hunt v. Shell).
 - AMI structure considerations in annotations re stratigraphic interests and termination processes.
- Subclause 8.01C: Major expansion to exempt certain acquisitions.
 - Units approved under Regulations and poolings required to complete a Spacing Unit.
 - Farmor increases its existing WI after termination of right to earn.
 - Farmor swaps like formations after termination of right to earn.
 - Party increases its WI in a former AMI parcel in which the other Party chose not to participate in the original acquisition.
 - Use of 2007/2015 CAPL 10% and 35% net hectares tests.
- Subclause 8.03B: New Subclause to address allocated values or inability to match consideration in kind-as in CAPL ROFR provision.
- Subclause 8.04D: Election deferral right has been made optional.
 - Much greater likelihood of delays beyond Farmee's control now.
- Note: Users might consider using upgrades immediately.

MAJOR CHANGES

Article 9.00-Well Information To Farmor

- Clause 9.03: Structured Paragraph 9.03A(b) with two Alternates.
 - To reflect one of the most common modifications to FO&RP.
 - Alternate 1-1997 approach for additional Royalty Wells.
 - Alternate 2-Access to information from all additional Royalty Wells.
 - Qualification for partial interest farmout for both Alternates if Existing Agreement with third parties precludes disclosure to the Farmor.
 - Royalty Payor otherwise in breach of contract under either Existing Agreement or the FO&RP.
 - Duty on part of the Royalty Payor to attempt to obtain required consents for disclosure under an Existing Agreement.
 - No such qualification available to Royalty Payor for subsequent agreements, as those are within its control at negotiation stage.
 - Tightened up Crown sale exception for both Alternates.
 - Note: Users might consider using the new Alternate immediately if this Clause is to be amended in a transaction.

MAJOR CHANGES

Article 10.00-Notices Under Existing Agreements

- New Article that addresses the possibility that Farmor may hold < 100% Working Interest with other third parties under an Existing Agreement.
 - Addresses issues typically not addressed or addressed on a custom basis in the Head Agreement.
- Clause 10.01: Operation Notices being served on behalf of the Farmee.
- Clause 10.02: Operation Notices being served on the Farmor by a third party during earning phase.
 - A number of potential permutations in this Clause linked to the timing of the proposal relative to the earning status for the applicable lands.
- Clause 10.03: Unless otherwise provided in Head Agreement, any consequence of non-participation by a third party accrues to the Farmee relative to the Farmor insofar as Farmee incurred the applicable costs.
 - An issue often ignored currently in a Head Agreement.
- Clause 10.04: Addresses situation in which a third party proceeds with a Completion for a well that the Farmor and Farmee had agreed should be Abandoned.
- Note: Users might consider using portions of this Article immediately.

MAJOR CHANGES

Article 12.00-Assignment

- Clause 12.01: Application of Subclause 24.04B of Operating Procedure applies the same principles as in CAPLA's "Segregation Protocol".
- Subclause 12.02B: Affirms approach in 1997 document whereby Parties in a BPO position will have ROFR rights and obligations for the BPO well and lands as if APO interests applied.
 - Rationale and application addressed in expanded annotations.
 - Annotation about potential "generally accepted industry practice" argument on this issue under older agreements.
 - Annotation that Clause 17.01 of the 1997 document and Clause 18.01 of this document ensure that ROFR handling in Clause 12.02 is consistent with Working Interest definition in the 2007 and 2015 CAPL Operating Procedures.

MAJOR CHANGES

Article 13.00-Land Maintenance Costs

- Subclause 13.01B: New Subclause addresses handling of land maintenance charges on the first anniversary date after earning.
 - Farmout Lands bear the entire burden of land applicable land maintenance charges.
 - No allocation to Farmor's Reserved Formations, except for zonal compensatory royalties or otherwise provided in Head Agreement.
- Clause 13.02: Presented as three Alternates.
 - Alternate 1-New in this document-no reimbursement for earning phase rentals.
 - Reflects the view that rental adjustments during the earning phase are immaterial for the typical small deal.
 - Alternate 2-1997 approach-payment of a prescribed lump sum for earning phase rentals.
 - Alternate 3-New in this document-Head Agreement addresses handling of earning phase rentals.
 - Chose not to include a per diem provision in the Clause.
 - Extra length, and could encourage use on smaller deals.

MAJOR CHANGES

Article 14.00-Default

- Subclause 14.01C: Clarified extent of application to a Farmee that failed to remedy a default.
 - Application to interests still in the process of being earned.
 - Application to ability to Spud additional Earning Wells.
 - Termination of future obligations of the Farmor to the Farmee (but not a Farmee to a Farmor) with respect to Area of Mutual Interest.
 - Reference to the circumstance in which the Farmee disputes the allegation that there is a default to which this Subclause applies.
- Annotations addressing the interrelationship of Subclause 14.01A and C in context of the EOG case relating to the 1997 document.
- Note: Users might consider using portions of this Subclause immediately.

MAJOR CHANGES

Article 15.00-Dispute Resolution

- Users select whether to apply optional Article 21.00 of 2007 CAPL.
 - Not selecting that Article would see arbitration being used under the Arbitration Act, rather than through the prescribed “rules”.
- Listed arbitration items are typically fact type matters:
 - Paying Quantities and related 3.01E and 3.05A determinations.
 - Clause 5.03 Allocation Ratio.
 - Reasonable efforts to produce a Royalty Well equitably-5.08.
 - Audit disputes under FO&RP for an amount less than \$50K.
 - Allocated value or non-cash consideration respecting Mutual Interest Lands (as in the CAPL Operating Procedure ROFR provision).
- Annotation explaining why arbitration is included for the listed items.
 - Actually included to discourage the use of arbitration, not encourage.
 - Reinforce to the Party in the “power position” to negotiate more reasonably than would be the case if litigation were the choice.
 - To motivate Parties to arrive at a negotiated outcome.
 - No historic proliferation of arbitration under Operating Procedure on more critical items (ROFR values, title preserving well issues, etc.).

MAJOR CHANGES

Article 16.00-Reserved Formations

- Clause 16.02: New Clause to address the Farmee's mutual obligations to the Farmor.
 - Duty to mitigate negative impacts on the Farmor's activities in the Reserved Formations.
 - Note: Users might consider using immediately.

Article 18.00-Applications Of Procedures To Subsequent Ops

- Clause 18.02: New optional Clause to provide content often provided in a Head Agreement.
 - Reduces likelihood that a Farmor forgets to consider the issue.
 - Addresses aspects often ignored respecting: (i) an exception for Clause 10.10 operations; (ii) operations on Mutual Interest Lands other than as required under Clause 8.05; and (iii) restrictions on the Farmee for an Earning Block conditionally earned by Capping.
 - Note: Users might consider using immediately.
- Clause 18.04: New Clause to address the possibility that a Party other than the Operator/Farmee is the Title Administrator.
 - Note: Users might consider using immediately.

SO, WHAT'S IN IT FOR YOU AND YOUR COMPANY?

The 2015 Farmout & Royalty Procedure is an instrument of opportunity...

Obtaining familiarity with this document in the near-term:

- Better enables you to understand and address issues you have with your current agreements.
 - Enhanced efficiency when required to do more with even less, better business outcomes and more constructive business relationships.
- Offers additional insights for use in structuring new agreements.
- Positions you to use the document more quickly when it inevitably comes across your desk.
- Improves your personal and organizational capability in this area.

This document offers significant benefits to Farmors, Farmees, large companies and small companies.

- Sample agreements in the Addendum offer compelling case for change.
- It is in our best interest as an industry and as individuals to transition to use as quickly as is feasible.
- Initial change management effort is small relative to the tangible gains.

MAY THE FORP BE WITH YOU!

The emphasis now shifts to the transition to use-awareness and education.

- The parallel projects of updates to the Farmout & Royalty Procedure and the Operating Procedure reinforce use of both documents.
 - Users require greater breadth and depth of coverage for Hz wells.
 - Expect much faster transition than for the 2007 Operating Procedure.
- A multi-pronged approach to facilitate the transition to use.
 - Daily Oil Bulletin article to increase industry awareness of the project.
 - Introductory mini-courses available shortly from CAPL.
 - More intensive courses available from CAPL early in 2016.
 - Ongoing articles in The Negotiator and NEXUS.
- A critical mass of early embracers would provide the greatest impetus to change, though.

As the Star Wars character Yoda would say: “To join us on the next phase of the journey, we hope that you choose. Herh Herh Herh Herh!”