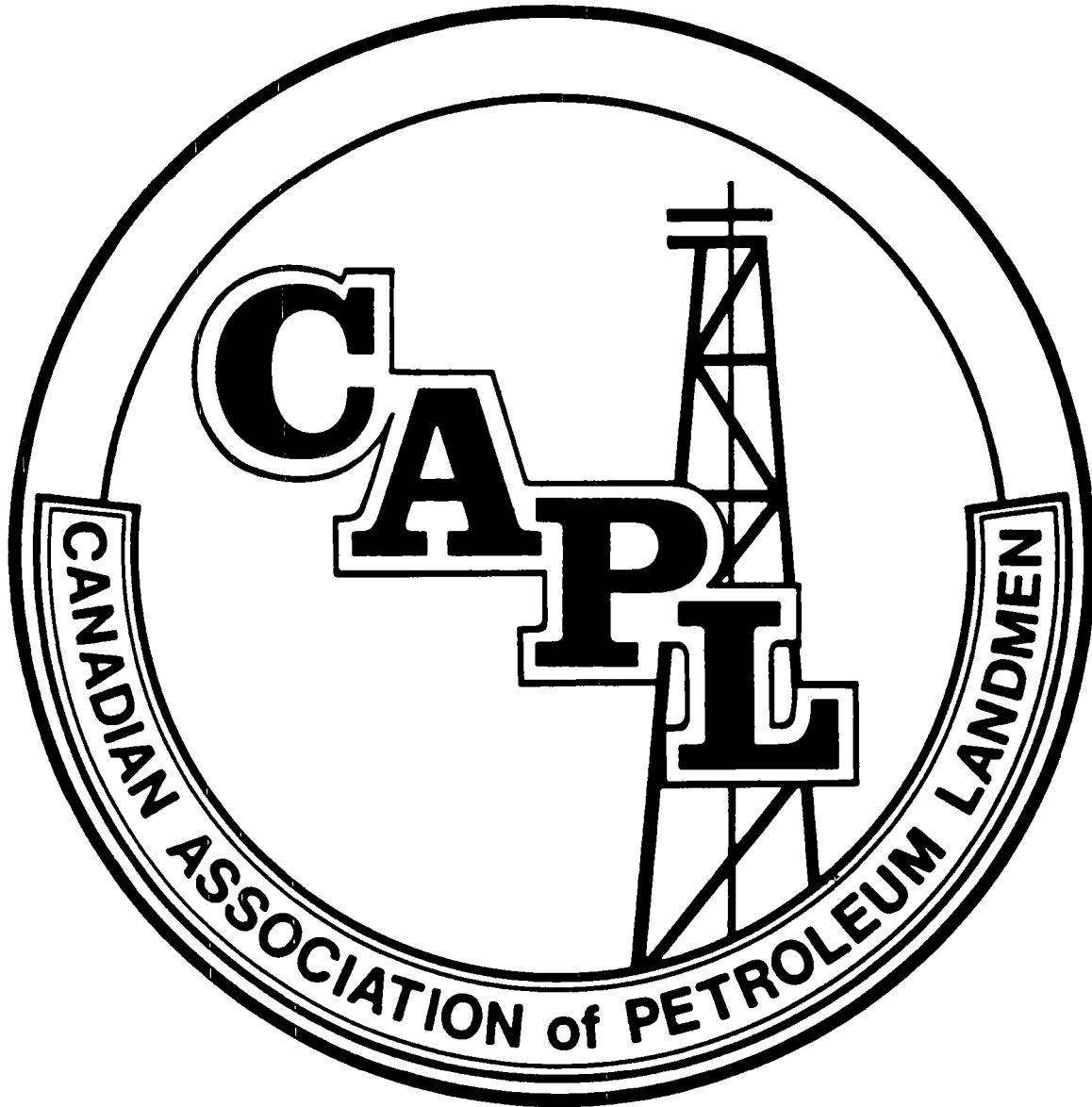


ROYALTY PROCEDURE

(Annotated)



CANADIAN ASSOCIATION OF PETROLEUM LANDMEN

Version 1.0

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**** Optional Clause**

Royalty Procedure

The explanatory notes reflect the observations of the authors and other commentators on the intention and scope of the provisions of the Royalty 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 Royalty Procedure are

- 1 to provide as much commonality as practicable in the post earning phase of a Farmout Agreement and
- 2 to reinforce the royalty as an interest in land

With regard to the first goal it is quite likely (i) that the Operating Procedure and the Royalty Procedure would be effective concurrently for different portions of the Farmout Lands and (ii) that the Agreement would provide for a conversion such that the Operating Procedure could replace the Royalty Procedure for the Royalty Lands. Thus it was felt that the Operating Procedure and the Royalty Procedure should be as consistent as possible between the various portions of the Farmout Lands. The Operating Procedure was taken as the source of many provisions in this procedure to the extent that several provisions are incorporated by reference from the Operating Procedure since that document is already accepted by industry.

With regard to the second goal the trend in industry recently is to attempt to categorize a Farmor's retained royalty as an interest in land. To that end Farmors have retained a significant degree of operational content such as the right to take in kind, the right to information from wells on the Royalty Lands, the right to review sale contracts, a reversionary right at abandonment or surrender, and more recently the concept of a Royalty Lien.

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

Heading The Royalty Procedure like the Operating Procedure would be attached to an Agreement. At a minimum the Agreement should designate the Parties and lands to be made subject to this Royalty Procedure and the identity of the Grantor and Royalty Owner (which in most cases will be the Farmee and Farmor). Participants or Farmors reserving a Working Interest rather than an Overriding Royalty would not be made bound by the Royalty Procedure except to the extent Clause 802 in the Operating Procedure applies.

Clause 1.01

The following definitions were taken from the Alberta Oil and Gas Conservation Act:

Condensate Crude Oil Marketable Gas Natural Gas Liquids Raw Gas

If the Royalty Procedure is to be used outside Alberta refer to equivalent definitions to those found in the Alberta Oil and Gas Conservation Act and vary the definitions accordingly. With regard to the Western provinces one should note the following:

- 1) The other Western provinces do not define condensate, raw gas, or natural gas liquids in their corresponding legislation so one may wish to leave these terms undefined.
- 2) With respect to Crude Oil the relevant term is oil in Manitoba and Saskatchewan and petroleum in B.C.
- 3) With respect to Marketable Gas the Western provinces other than Alberta use a generic definition of natural gas so one may wish to delete this definition for those provinces.

Whatever changes are made to these terms should be reflected in the definition of Petroleum Substances and anywhere else in the Royalty Procedure that these substances are mentioned.

ROYALTY PROCEDURE

Attached to and forming part of the Agreement dated the _____ day of _____

BETWEEN/AMONG

I DEFINITIONS, INTERPRETATION AND INCORPORATION OF OPERATING PROCEDURE PROVISIONS

1 01 Definitions And Interpretation

In this Royalty Procedure the following words and phrases shall have the following respective meanings

- (a) **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 Royalty 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
- (b) **Condensate** means a mixture mainly of pentanes and heavier hydrocarbons that may be contaminated with sulphur compounds that is recovered or is recoverable at a well from an underground reservoir and that may be gaseous in its virgin reservoir state but is liquid at the conditions under which its volume is measured or estimated
- (c) **Crude Oil** means a mixture mainly of pentanes and heavier hydrocarbons that may be contaminated with sulphur compounds that is recovered or is recoverable at a well from an underground reservoir and that is liquid at the conditions under which its volume is measured or estimated and includes all other hydrocarbon mixtures so recovered or recoverable except Raw Gas or Condensate
- (d) **Grantor** means a Party having a Working Interest which is subject to the Overriding Royalty
- (e) **Marketable Gas** means a mixture mainly of methane originating from Raw Gas if necessary through the processing of the Raw Gas for the removal or partial removal of some constituents and which meets specifications for use as a domestic commercial or industrial fuel or as an industrial raw material
- (f) **Natural Gas Liquids** means propane butanes or pentanes plus or a combination of them obtained from the processing of Raw Gas or Condensate

Subclause 1.01 (h) The definition is set up this way in case the royalty is non-convertible and no Operating Procedure is attached to the Agreement

Subclause 1.01 (l) Usually the only Royalty Lands will be the earning well Spacing Units

Subclause 1.01 (n) The Test Well (and Option Well if applicable) would become Royalty Wells under this definition

- (g) **1990 Operating Procedure** means the 1990 Canadian Association of Petroleum Landmen's form of operating procedure
- (h) **Operating Procedure** means (i) the Schedule if any attached to the Agreement entitled Operating Procedure or (ii) if there is no such Schedule attached to the Agreement the 1990 Operating Procedure and as an attachment, the 1988 (February 1991 revision) Petroleum Accountants Society of Canada form of accounting procedure with rates and elections as the Parties concerned may negotiate at the required time
- (i) **Overriding Royalty** means that interest reserved by the Royalty Owner which is more particularly described in Article II (OVERRIDING ROYALTY) in this Royalty Procedure
- (j) **Petroleum Substances** means Condensate Crude Oil Natural Gas Liquids Raw Gas sulphur and every other mineral or substance or any of them an interest in or the right to drill for win take or remove same is granted or acquired under the Title Documents to the extent the Title Documents comprise the Royalty Lands or which are allocated to the Royalty Lands
- (k) **Raw Gas** means a mixture containing methane other paraffinic hydrocarbons nitrogen carbon dioxide hydrogen sulphide helium and minor impurities or some of them which is recovered or is recoverable at a well from an underground reservoir and which is gaseous at the conditions under which the volume is measured or estimated
- (l) **Royalty Lands** means those lands and interests therein which have been made subject hereto by the Agreement or so much thereof which remains subject hereto and except where the context otherwise requires shall include the Petroleum Substances within upon or under those lands and interests
- (m) **Royalty Owner** means a Party reserving the Overriding Royalty in the Royalty Lands as provided in Article II (OVERRIDING ROYALTY)
- (n) **Royalty Well** means (i) any well on or in the Royalty Lands from which production is subject to the Overriding Royalty and (ii) any well from which production is or may be allocated to the Royalty Lands pursuant to a pooling unit or other arrangement

In addition the following definitions from Clause 101 of the 1990 Operating Procedure as may be hereinafter modified are incorporated herein by reference

- (a) abandonment which is referred to as Abandonment herein
- (c) Affiliate
- (d) Agreement
- (h) completion which is referred to as Completion herein
- (s) market price which is referred to as Market Price herein and for which the phrase Article VI shall be replaced with Clause 5.03 (Royalty Owner Not Taking In Kind)
- (v) party which is referred to as Party herein
- (x) paying quantities which is referred to as Paying Quantities herein
- (bb) Regulations
- (cc) spacing unit which is referred to as Spacing Unit herein
- (dd) spud which is referred to as Spud herein and for which the phrase in the AFE shall be deleted
- (ee) title documents which is referred to as Title Documents herein
- (ff) 'working interest' which is referred to Working Interest herein and for which the phrase a production facility or shall be deleted

With regard to any definition and any Article or Clause incorporated by reference herein from the 1990 Operating Procedure any reference to Operating Procedure shall be read as Royalty Procedure petroleum substances shall be read as Petroleum Substances joint lands shall be read as Royalty Lands Joint Operator shall be read as Royalty Owner Operator shall be read as Grantor and references to for the joint account shall be deleted

Clause 1 04 If the interests or identities of the Parties vary among blocks Subclause (c) will need to be expanded to address each block

Clause 1 05 The main obligation to the Royalty Owner to which Paragraph (a) would apply is the payment of the Overriding Royalty

1 02 Incorporation Of Clauses From 1990 CAPL Operating Procedure

The following Clauses from the 1990 Operating Procedure are incorporated herein by reference

102 HEADINGS
103 REFERENCES
104 OPTIONAL AND ALTERNATE PROVISIONS
105 DERIVATIVES
106 USE OF CANADIAN FUNDS
1601 DEFINITION OF FORCE MAJEURE
1602 SUSPENSION OF OBLIGATIONS DUE TO FORCE MAJEURE
1603 OBLIGATION TO REMEDY
1604 EXCEPTION FOR LACK OF FINANCES
2001 WAIVER MUST BE IN WRITING
2101 PARTIES TO SUPPLY
2201 SERVICE OF NOTICE
2203 RIGHT TO CHANGE ADDRESS
2601 LIMITATION ON RIGHT OF ACQUISITION
2801 SUPERSEDES PREVIOUS AGREEMENTS
2802 TIME OF ESSENCE
2803 NO AMENDMENT EXCEPT IN WRITING
2804 BINDS SUCCESSORS AND ASSIGNS
2805 LAWS OF JURISDICTION TO APPLY
2806 USE OF NAME

1 03 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 Royalty 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 XIV entitled LIABILITY AND INDEMNITY) shall govern the relationship of the Parties. If there is a conflict as provided above the Agreement or this Royalty Procedure as the case may be shall be modified accordingly to the extent necessary to resolve such conflict and as so modified shall continue in full force and effect.

1 04 Royalty Owner Comprises More Than One Party

If at any time while this Royalty Procedure is in effect the Royalty Owner comprises more than one Party

- (a) all information and notices to be provided to the Royalty Owner by the Grantor shall be provided individually to each Party comprising the Royalty Owner
- (b) all elections provided to the Royalty Owner shall be made individually by each Party comprising the Royalty Owner and
- (c) subject to the rights of conversion if any provided for in the Agreement the rights and obligations of the Royalty Owners shall be several and shall accrue proportionately to the Royalty Owners as follows

_____	_____%
_____	_____%
_____	_____%

1 05 Grantor Comprises More Than One Party

If at any time while this Royalty Procedure is in effect the Grantor comprises more than one Party

- (a) the obligations and liabilities of the Grantor to the Royalty Owner shall be joint and several

Clause 2 01

- (i) The issue of an overriding royalty being an interest in land has been addressed in several court cases and various articles. While the weight of authority suggests an overriding royalty can be an interest in land, the overriding royalties that were the subject of the majority of these cases were not strong enough to be an interest in land. The question of whether an overriding royalty can be an interest in land has been the subject of much discussion because of the Farmor's desire to protect its interest against subsequent third party purchasers including for freehold lands, registering the Overriding Royalty under the applicable Land Titles Act.
- (ii) The first two sentences are structured this way to reinforce the concept of the Overriding Royalty as an interest in land. Other provisions in this Royalty Procedure also give the Royalty Owner more of an active interest in the Royalty Lands than the mere receipt of money; these provisions include the creation of a royalty lien, the right to take in kind, the right to review sales contracts, reversionary rights upon expiry or surrender, and the right to enforce a royalty lien by seizing the Farmee's property.
- (iii) Alternate A may be used to avoid the administrative complications of calculating a sliding scale Overriding Royalty.
- (iv) For Alternate B, basic sediment and water are removed before the percentage of Crude Oil is calculated.
- (v) The first sentence of the last paragraph allows the Royalty Procedure to be usable where a Royalty Owner has less than a 100% Working Interest to grant to the Grantor. If this Royalty Owner only had a 50% Working Interest to farmout to the Grantor and if the relevant Overriding Royalty percentage was 15%, the Overriding Royalty calculated under this Clause becomes 15% multiplied by 50% for a net of 7.5%. If one wished to insert net figures in the blanks (i.e. insert 7.5% rather than 15% in the current example), this sentence should be deleted as well as and the phrase (based on a grant of a 100% Working Interest) in the preceding paragraph.
- (vi) If a Royalty Well is producing oil from more than one zone, the sliding scale is calculated separately for each zone. This is the way the Alberta Crown applies its lessor royalty. The exception is to take into account commingling authorized pursuant to Clauses 3.050 and 15.220 of the Oil and Gas Conservation regulation.
- (vii) Take special note that the Overriding Royalty set forth in this Clause is based on a percentage of production of Petroleum Substances from the Royalty Lands, not a percentage of the proceeds of sale of production received by the Grantor. Therefore, in a situation where (i) the Grantor is subject to an Operating Procedure with other Working Interest owners not subject to the Overriding Royalty, (ii) the Overriding Royalty is not a recognized encumbrance on the Grantor's Working Interest under that Operating Procedure (within the meaning of Article VIII of the 1990 Operating Procedure, and (iii) the Grantor elects to be in a penalty position for a well drilled as an independent operation under the Operating Procedure, the Grantor must pay the Overriding Royalty on the production from that independent well even though the Grantor is receiving no revenue from same for the time it is in penalty.

- (b) the Royalty Owner shall be entitled to recognize solely _____ as the representative of the Grantor with respect to all matters under this Royalty Procedure provided that the Grantor may change such representative with the consent of the Royalty Owner which consent shall not be unreasonably withheld and
- (c) subject to the rights of conversion if any provided for in the Agreement the Working Interests in the Royalty Lands granted under Article II (OVERRIDING ROYALTY) shall accrue proportionately to the Grantor as follows

_____	_____	%
_____	_____	%
_____	_____	%

II OVERRIDING ROYALTY

2 01 Quantification Of Overriding Royalty

Effective as of the date and in the manner provided in the Agreement the Royalty Owner grants to the Grantor the Royalty Owner s entire right title and interest in and to its Working Interest in the Royalty Lands except for the Overriding Royalty reserved by the Royalty Owner The Royalty Owner reserves out of the Working Interest hereby granted an Overriding Royalty which shall comprise a portion of the Petroleum Substances within upon and under the Royalty Lands The gross volume of Petroleum Substances comprising the Overriding Royalty (based on a grant of a 100% Working Interest) shall be as follows

- (a) for Crude Oil Alternate _____ shall apply (Specify A or B)

Alternate A

_____ percent (____%) of the gross monthly production thereof produced from each Royalty Well and

Alternate B

gross monthly production thereof multiplied by the quotient (which shall be deemed to be a percentage) determined by dividing the gross monthly production of Crude Oil (expressed in cubic metres but excluding basic sediment and water) produced from each Royalty Well by _____ which percentage shall not be less than _____ percent (____%) and shall not be more than _____ percent (____%) and

- (b) for all other Petroleum Substances _____ percent (____%) of the gross monthly production thereof produced from each Royalty Well

This reservation shall be multiplied by the percentage Working Interest held by the Royalty Owner immediately before this Royalty Procedure came into effect If the Grantor Completes a Royalty Well on the Royalty Lands for Crude Oil in two or more zones of the Royalty Lands the Overriding Royalty shall be quantified separately for each such zone except and to the extent that the Crown in right of the Province in which the Royalty Lands are situate permits the Grantor to commingle production from two or more zones for the purpose of royalty payments under that Title Document

2 02 Petroleum Substances Not Reserved To Royalty Owner

The reservation of the Overriding Royalty to the Royalty Owner shall not include Petroleum Substances which the Grantor uses and considers to be reasonably necessary for the Grantor s drilling and production operations for the Royalty Lands and shall not include Petroleum Substances which the Grantor unavoidably loses in those drilling and production operations These drilling and production operations include the use of those unreserved Petroleum Substances in batteries treaters compressors separators satellites and similar equipment serving only Royalty Wells on the Royalty Lands but shall not include the use of Petroleum Substances for any enhanced recovery operations or fuel stock for any battery or satellite serving wells in addition to Royalty Wells on Royalty Lands or for any gas plant or refinery

Clause 3 01

- (i) This Clause is derived from the pooling clause in the CAPL petroleum and natural gas freehold lease form
- (ii) Note the reference to petroleum substances rather than Petroleum Substances. The latter is a defined term restricted to the Royalty Lands. Therefore a different term is necessary when outside the boundaries of Royalty Lands.

Clause 3 02 In addition to the commonly used poolings and units, the Alberta Oil and Gas Conservation Act includes a block and a project, hence the term combination.

Clause 3 03 Note that an allocation of Petroleum Substances may be on other than an acreage basis if appropriate in the circumstances.

2.03 Royalty Wells To Be Produced Rateably

Subject to Clause 5.01 (Royalty Owner May Take Overriding Royalty In Kind) the Grantor shall make every reasonable effort within its legal authority to produce Petroleum Substances from Royalty Wells rateably with any other similar substances produced from any well producing from Spacing Units contiguous to and within the same pool as the Royalty Well Spacing Unit insofar as the Grantor or an Affiliate of the Grantor has an interest in those Spacing Units. The Grantor covenants that it will not discriminate against the Petroleum Substances produced or capable of being produced from the Royalty Lands in the production of same.

III POOLING OR UNITIZATION

3.01 Poolings Authorized By Royalty Owner

The Grantor shall have the authority to pool the Petroleum Substances in a zone underlying all or a portion of the Royalty Lands to the extent required to form a Spacing Unit in such zone but only if such pooling allocates to that portion of the Royalty Lands included in the Spacing Unit that proportion of the total production of petroleum substances from the Spacing Unit which the surface area of that portion of the Royalty Lands placed in the Spacing Unit bears to the total surface area of the Spacing Unit. The Grantor shall thereafter give written notice to the Royalty Owner describing the extent to which the Royalty Lands are being pooled and describing the Spacing Unit with respect to which they are so pooled.

3.02 Consent Of Royalty Owner Required

If the Grantor wishes to pool any portion of the Royalty Lands with any other lands other than as provided in the previous Clause or to unitize or otherwise combine any portion of the Royalty Lands with any other lands the Grantor shall promptly send notice to the Royalty Owner of such intention together with the technical justification for such pooling, unitization or combination and the proposed terms thereof provided that this Clause shall not require the Grantor to provide interpretative data to the Royalty Owner. Unless otherwise required by the Regulations to form a Spacing Unit the Grantor shall not enter into that pooling, unitization or combination without obtaining the prior written consent of the Royalty Owner which consent shall not be unreasonably withheld.

3.03 Allocation Of Petroleum Substances

If all or any portion of the Royalty Lands is pooled, unitized or combined (which combination allocates Petroleum Substances to the Royalty Lands) with any other lands pursuant to one of the preceding Clauses of this Article, Clause 2.01 (Quantification Of Overriding Royalty) shall be deemed to have been amended to the extent and for so long as necessary to permit the volume of Overriding Royalty to be calculated by multiplying that quantity of Petroleum Substances allocated to the affected Royalty Lands pursuant to that pooling, unitization or combination by the percentages set forth or determined in that Clause. If the pooling, unitization or combination affects Crude Oil and Alternate B is specified to be in effect for Clause 2.01 (Quantification Of Overriding Royalty) the gross monthly production to be used in determining the percentage shall be

- (a) for poolings using Royalty Lands to form a Crude Oil Spacing Unit the total production of Crude Oil from Royalty Well from which Crude Oil is to be allocated pursuant to the instrument of agreement creating that pooling and
- (b) for other forms of poolings or for unitizations or combinations whereby Crude Oil is allocated to Royalty Lands comprising all or a portion of a Crude Oil Spacing Unit the total amount of Crude Oil production allocated to the Spacing Unit pursuant to the instrument of agreement creating that pooling, unitization or combination

Clause 4 01

- (i) Note the reference to removing basic sediment and water See comment to Clause 5 02.
- (ii) Paragraph (b)(ii) is derived from paragraph 1021(d) and Clause 1404 of the Operating Procedure The paragraph regarding disputes is based on Clause 1409 of the Operating Procedure with the addition of a reference to mediation
- (iii) A similar provision is found in paragraph (iii) of the Payout definition in the Farmout Procedure and the rationale for its inclusion is the same The Farmee should not be penalized for using owned facilities rather than third party facilities
- (iv) The third paragraph of this Clause provide three provisions common in industry providing down side protection for the Farmor s Overriding Royalty
- (v) In Alternate C the minimum royalty is based on Raw Gas production Therefore the Grantor must sum the proceeds of sale of Marketable Gas with the proceeds of sale of all other products derived from Raw Gas and compare that amount with the production of Raw Gas multiplied by the dollar amount inserted
- (vi) In order that the wording of these minimum Alternates in the Clause be readily understandable these Alternates have been drafted referring to the permitted deductions as cash items As an interest in land the rights and obligations of the Overriding Royalty should be expressed in terms of the underlying right to Petroleum Substances not to the proceeds of sale thereof and cash deductions from those proceeds The last paragraph has been inserted to clearly indicate that the wording in the Procedure does not intend to in any way detract from the Overriding Royalty being an interest in land

IV OVERRIDING ROYALTY NOT TAKEN IN KIND

4.01 Grantor's Allowed Deductions

To the extent the Grantor disposes of Petroleum Substances comprising the Overriding Royalty on behalf of the Royalty Owner, the Royalty Owner's rights to those Petroleum Substances shall be free of any rights of the Grantor to make deductions for costs and expenses incurred by the Grantor relating to those Petroleum Substances except the following:

- (a) for Crude Oil and Condensate, the Grantor's actual costs to remove basic sediment and water from and to treat the Crude Oil and Condensate and to transport those Petroleum Substances to market connection where sales are not made from the tanks serving the relevant Royalty Wells;
- (b) for Petroleum Substances other than Crude Oil and Condensate:
 - (i) the Grantor's actual costs incurred by payment to third parties (other than Affiliates of the Grantor) to transport those Petroleum Substances to the delivery point in the relevant contract of sale and to gather, compress, treat and process those Petroleum Substances; and
 - (ii) to the extent that transportation, gathering, compressing, treating and processing facilities owned by the Grantor or an Affiliate of the Grantor are utilized to transport, gather, compress, treat and process Petroleum Substances comprising the Overriding Royalty, 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 comprising the Overriding Royalty produced from the Royalty 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 Grantor'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.

If there is a dispute between or among Royalty Owner Parties and Grantor Parties with respect to the facility usage fee for facilities pursuant to this Clause, that dispute 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 dispute may elect by notice to the other Parties involved in the dispute to have the 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.

If a cost or expense is attributable to more than one Petroleum Substance so being sold by the Grantor, such charge or expense shall only be deducted once.

Notwithstanding anything in this Clause, the deductions applicable to the Petroleum Substances comprising the Overriding Royalty for any month shall be subject to Alternates _____ below (Specify A, B and/or C).

ALTERNATE A.

The deductions shall not exceed those which would be permitted by the Regulations for the calculation of royalties in the event the lessor of the relevant Title Documents were the Crown in right of the Province in which the Royalty Lands are located.

Clause 4 03 If the Royalty Lands are Crown this optional Clause would require the use of Crown deductions and Crown pricing

ALTERNATE B

The deductions shall not reduce the amount payable by the Grantor to the Royalty Owner to less than _____ percent (_____%) of gross proceeds from the sale of Petroleum Substances comprising the Overriding Royalty

ALTERNATE C

The deductions shall not reduce the amount payable by the Grantor to the Royalty Owner for Petroleum Substances comprising the Overriding Royalty consisting of Raw Gas to less than \$_____ per 10³m³ of Raw Gas produced at the wellhead

The Grantor's right to make the foregoing deductions from the proceeds of sale of the Petroleum Substances comprising the Overriding Royalty is

- (a) a right to deduct a portion of those Petroleum Substances which is or is deemed to be the equivalent to that portion of those Petroleum Substances which the Royalty Owner would be required to take in kind and to sell in order to pay for what would be the Royalty Owner's costs and expenses to bring those Petroleum Substances to the point of sale
- (b) expressed for convenience of record keeping and audit as cash obligations which are deductible from the proceeds of sale of the Petroleum Substances comprising the Overriding Royalty

4.02 Grantor To Account To Royalty Owner Monthly

When the Grantor receives any money on account of or as the proceeds of sale of the Petroleum Substances comprising the Overriding Royalty the Grantor shall receive that money as trustee for the Royalty Owner. The Grantor shall remit to the Royalty Owner all monies accruing to the Royalty Owner on account of the Overriding Royalty on or before the last day of the calendar month next following the calendar month in which such Petroleum Substances were sold. The Grantor shall enclose with that payment a copy of all reports the Grantor is required to submit under the Regulations for the production of such Petroleum Substances and a written statement showing in reasonable detail the manner in which the Grantor calculated that payment.

Optional Clause 4.03 shall not _____/shall _____ (Specify) be included herein. Failure to specify shall be deemed an election to not include this optional Clause herein.

4.03 Overriding Royalty On Crown Lands

To the extent the Grantor disposes of Petroleum Substances comprising the Overriding Royalty on behalf of the Royalty Owner where the lessor under the Title Documents for the Royalty Lands concerned is the Crown in the right of the Province in which the Royalty Lands are located the proceeds of sale of the Overriding Royalty which the Grantor realizes from that disposition shall be subject to the same adjustments for costs and expenses of bringing those Petroleum Substances to the point of sale as the Grantor would be entitled to deduct therefrom if the Overriding Royalty were the lessor royalty accruing to that Provincial Crown. Regulations pertaining to prices for the calculation of royalties payable to the Crown as lessor for those Royalty Lands shall apply to the Petroleum Substances comprising the Overriding Royalty in determining the value of the Overriding Royalty.

V RIGHT TO TAKE OVERRIDING ROYALTY IN KIND

5.01 Royalty Owner May Take Overriding Royalty In Kind

The Royalty Owner may by notice to the Grantor elect to take delivery and separately dispose of all or a portion of the Petroleum Substances comprising the Overriding Royalty at the delivery point specified in the immediately following Clause. The Royalty Owner shall supply the Grantor with such information regarding the Royalty Owner's arrangements for disposition of the Petroleum Substances comprising the Overriding Royalty as the Grantor may reasonably require to allow the Grantor to fulfill its obligations hereunder and under the Title Documents.

Clause 5 02 Note the reference to basic sediment and water This runs contrary to similar provisions seen in many industry farmout agreements However the cost to remove sediment and water can be significant Therefore the Royalty Owner should be responsible for removal The same rationale applies to processing costs prior to the first point of measurement

Clause 5 03 This Clause is derived from Subclause 602(a) of the Operating Procedure Note that the election may be for some but not all types of Petroleum Substances produced

Clause 5 04 This Clause is derived from Subclause 602(b) of the Operating Procedure The last sentence addresses conversion

5.02 Grantor's Responsibilities Where Royalty Owner Takes In Kind

For the Petroleum Substances comprising the Overriding Royalty other than Raw Gas the Grantor shall at the Royalty Owner's cost remove basic sediment and water from such Petroleum Substances in accordance with good oilfield practice so that relevant pipeline specifications can be met. If requested by the Royalty Owner the Grantor shall provide the Royalty Owner at the Grantor's cost production tankage capacity for not more than ten (10) days accumulation of the Petroleum Substances comprising the Overriding Royalty other than Raw Gas. The Grantor shall deliver the Petroleum Substances comprising the Overriding Royalty other than Raw Gas to the Royalty Owner or its nominee at the tank outlets in accordance with usual and customary pipeline and shipping practice free and clear of all charges whatsoever except for the removal of basic sediment and water if applicable.

For the Petroleum Substances comprising the Overriding Royalty consisting of Raw Gas the Grantor shall deliver the same to the Royalty Owner or its nominee at the first point of measurement for the relevant well. To the extent that the Grantor compresses, treats and processes that Raw Gas prior to the first point of measurement the Grantor may charge the Royalty Owner for the actual costs of that compressing, treating and processing.

5.03 Royalty Owner Not Taking In Kind

If the Royalty Owner is taking Petroleum Substances comprising the Overriding Royalty in kind pursuant to Clause 5.01 (Royalty Owner May Take Overriding Royalty In Kind) the Royalty Owner may by notice to the Grantor elect to cease taking delivery of all or a portion of those Petroleum Substances in kind and appoint the Grantor as agent of the Royalty Owner for the disposition of those Petroleum Substances. To the extent the Royalty Owner does not take delivery and separately dispose of the Petroleum Substances comprising the Overriding Royalty and does not appoint the Grantor as agent pursuant to this Clause the Grantor shall be deemed to be appointed as agent for the disposition of those Petroleum Substances so affected. If after being appointed agent or being deemed to have been appointed agent under this Clause the Grantor produces Petroleum Substances the Grantor shall dispose of the Petroleum Substances comprising the Overriding Royalty so affected by

- (a) selling such Petroleum Substances at a Market Price and accounting to the Royalty Owner for the proceeds of the sale; or
- (b) purchasing such Petroleum Substances for the Grantor's own account (or the account of an Affiliate) at a Market Price and accounting to the Royalty Owner therefor.

All acts of the Grantor under this Clause for the taking possession of, selling and receiving the proceeds of sale of the Petroleum Substances comprising the Overriding Royalty shall be as trustee for the Royalty Owner.

5.04 Proposed Sale Contracts Where Royalty Owner Not Taking In Kind

The Grantor may only purchase the Petroleum Substances comprising the Overriding Royalty pursuant to the preceding Clause under an arrangement that, as it affects those Petroleum Substances, is terminable at any time on not greater than one (1) month's notice by the Royalty Owner to the Grantor without an early termination penalty or other cost.

If the Grantor proposes to sell production under a sale contract which is not terminable at any time on notice of one (1) month or less as to the Petroleum Substances comprising the Overriding Royalty to be sold thereunder the following shall apply:

- (a) the Grantor shall give notice to the Royalty Owner of such intention and provide it with a summary of the terms of the proposed contract in sufficient detail to enable the Royalty Owner to determine whether it wishes that portion of those Petroleum Substances affected by that contract to be sold pursuant to the proposed contract;
- (b) the Royalty Owner shall give notice to the Grantor within ten (10) days of receipt of the Grantor's notice whether it consents to having those Petroleum Substances sold under the proposed contract, provided that

Clause 5 05 This Clause is derived from Subclause 603(c) of the Operating Procedure

Article VI

- (i) This Article is derived from the corresponding provision of the 1988 PASC Accounting Procedure
- (ii) The last sentence of Clause 6 01 protects the Grantor from having to disclose gas contracts under which it sold its production that it considers proprietary where it sells Overriding Royalty production under same This is consistent with the concept underlying Clause 607 of the Operating Procedure
- (iii) The rationale for Clause 6 03 is that the Grantor should keep good records If an audit discloses that the Grantor s records were in error to some significant degree the cost for the audit should be borne by the Grantor

failure of the Royalty Owner to notify the Grantor of its position within this period shall be deemed to be the consent of the Royalty Owner to the sale of those Petroleum Substances pursuant to the proposed contract

- (c) if the Royalty Owner consents or is deemed to consent pursuant to the preceding Subclause the Grantor shall sell those Petroleum Substances under such contract provided that if the Royalty Owner gives notice that it does not consent pursuant to Subclause (b) the Royalty Owner shall state in its notice whether it intends to commence taking in kind and separately disposing of those Petroleum Substances pursuant to Clause 5.01 (Royalty Owner May Take Overriding Royalty In Kind) and
- (d) if the Royalty Owner does not consent to having those Petroleum Substances sold under the proposed contract pursuant to this Clause and does not proceed to take in kind and separately dispose of that production the Grantor may dispose of those Petroleum Substances pursuant to the previous Clause

If the Royalty Owner retains a right to convert its Overriding Royalty to a Working Interest pursuant to the Agreement and the Royalty Owner elects to so convert when that right accrues the Working Interest to which the Overriding Royalty is converted shall be subject to the production sale arrangements to which the Royalty Owner consented or was deemed to have consented to pursuant to this Clause

5.05 Royalty Owner's Right To Resume Taking In Kind

If the Grantor is disposing of Petroleum Substances comprising the Overriding Royalty as the agent of the Royalty Owner and if the Royalty Owner gives notice to resume taking delivery of such Petroleum Substances comprising the Overriding Royalty in kind pursuant to Clause 5.01 (Royalty Owner May Take Overriding Royalty In Kind) the Grantor's appointment as agent of the Royalty Owner under Clause 5.03 (Royalty Owner Not Taking In Kind) shall be revoked. This notice shall be effective either at the end of the term of any sale contract pursuant to which that production is being sold by the Grantor or at the date the sale contract insofar as it affects the Petroleum Substances comprising the Overriding Royalty is terminated if so terminable by the Grantor at an earlier date. However, this notice shall not be effective with respect to a contract which is terminable by the Grantor unless the Grantor has received the notice at least fifteen (15) days prior to any specified date upon which the Grantor is required to serve notice to the applicable purchaser to terminate the sale contract as it affects the Petroleum Substances comprising the Overriding Royalty

VI AUDITS

6.01 Examination Of Records

The Royalty Owner may upon reasonable notice to the Grantor and at the Royalty Owner's own expense audit the records of the Grantor with respect to the Overriding Royalty. The Royalty Owner may conduct such audit within the calendar year in which such records were made and the twenty four (24) month period next following the end of such calendar year. The Grantor shall not be required to provide the auditors with access to any contract pursuant to which the Grantor sold its share of Petroleum Substances

6.02 Discrepancies And Settlements

Any claims of discrepancies disclosed by the audit shall be made in writing to the Grantor within two (2) months following the completion of the audit. The Grantor shall respond in writing to any claims of discrepancies within six (6) months of receipt of the claims. To the extent that the Parties are unable to resolve any outstanding claims of discrepancies disclosed by the audit such audit exceptions 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 in that audit exception to have such audit exception resolved pursuant to the Arbitration Act of the Province of Alberta (R.S.A. 1991 c. 43.1) as amended from time to time

However, any statement rendered by the Grantor to the Royalty Owner with respect to the production disposition or sale of the Overriding Royalty and the permitted charges applicable thereto made by the Grantor shall be

Clause 7.02 This Clause is derived from paragraph (i) of Subclause 505(b) and Subclause 505(c) of the Operating Procedure

Clause 7.03 This Clause is derived from Paragraphs (iii) (iv) (v) and (vi) except for the right to sell the Grantor's interest of Subclause 505(b) of the Operating Procedure. The authors did not incorporate the right to sell the Grantor's interest because, aside from being a harsh remedy, there was a possibility that Working Interest owners would be exercising that right at the same time.

deemed to be correct twenty-six (26) months following the end of the calendar year in which the statement was received by the Royalty Owner unless and to the extent that the statement is disputed by the Royalty Owner before the end of that period

6.03 Discrepancies Causing Grantor To Pay For Audit

Notwithstanding Clause 6.01 (Examination Of Records) if the claims of discrepancy cause changes to the Grantor's records increasing the amount of money or volume for the Overriding Royalty by more than twenty percent (20%) of the amount calculated for the Overriding Royalty by the Grantor for the period under audit the Grantor shall pay to the Royalty Owner immediately upon receipt of an invoice for same the reasonable cost of the audit to which the claims of discrepancy relate

VII ROYALTY OWNER'S RIGHTS IN EVENT OF DEFAULT

7.01 Royalty Owner's Lien

As of the effective date that the Overriding Royalty is reserved by the Royalty Owner the Royalty Owner shall have a first and prior lien on the Working Interest of the Grantor in the Royalty Lands the Petroleum Substances within upon or under such lands or produced therefrom and the wells and other equipment thereon to secure the Overriding Royalty and both the Overriding Royalty and such lien shall be interests in land and shall attach to the Title Documents

7.02 Royalty Owner's Right To Charge Interest

If the Grantor fails to pay to the Royalty Owner the proceeds of the sale of the Petroleum Substances comprising the Overriding Royalty pursuant to Article IV (OVERRIDING ROYALTY NOT TAKEN IN KIND) or any other amount the Grantor is obligated to pay as provided in this Royalty Procedure the Royalty Owner may without limiting the Royalty Owner's other rights as contained in this Royalty Procedure or otherwise held at law or in equity charge the Grantor compound interest calculated and accrued monthly with respect to such 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 Royalty Owner regardless of whether the Royalty Owner has notified the Grantor in advance of its intention to charge interest with respect to such 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 and the Grantor waives the application of any Regulations to the contrary where permitted by the Regulations

7.03 Royalty Owner's Remedies If Default Continues As To Overriding Royalty

If the Grantor fails to pay to the Royalty Owner the proceeds of the sale of the Petroleum Substances comprising the Overriding Royalty pursuant to Article IV (OVERRIDING ROYALTY NOT TAKEN IN KIND) as provided hereunder the Royalty Owner may give the Grantor notice specifying the default and requiring the same to be remedied If the Grantor fails to commence and diligently pursue remedying the default specified therein within thirty (30) days following the receipt by the Grantor of such notice the Royalty Owner may without limiting the Royalty Owner's other rights as contained in this Royalty Procedure or otherwise held at law or in equity

- (a) set-off against the amount unpaid by the Grantor any sums due or accruing to that Grantor from the Royalty Owner pursuant to the Agreement or any other agreement between the Royalty Owner and that Grantor whether entered into before or after the effective date of the Agreement
- (b) treat the default as an immediate and automatic assignment to the Royalty Owner of the proceeds of the sale of Petroleum Substances from the Royalty Lands service of a copy of this Royalty Procedure upon a purchaser of such Petroleum Substances together with written notice from the Royalty Owner shall constitute an irrevocable direction by the Grantor to any such purchaser to pay to the Royalty Owner the

Clause 8 01 This is based on Subclause 309(a) of the Operating Procedure

Clause 8 02 This is derived from the last sentence of Subclause 309(b) of the Operating Procedure

Clause 8 03 This is derived based on Clauses 801 and 802 of the Operating Procedure

proceeds from any sale up to the amount owed to the Royalty Owner by the Grantor hereunder (including any accrued interest with respect thereto) and such purchaser is authorized by such Grantor to rely upon the statement of the Royalty Owner as to the amount so owed to it by the Grantor and

- (c) maintain an action or actions for such unpaid amounts and interest thereon on a continuing basis as such amounts are payable but not paid by the Grantor as if the obligation to pay such amounts and the interest thereon were liquidated demands due and payable on the relevant date such amounts were due to be paid without any right or resort of the Grantor to set-off or counterclaim

Upon expiry of the thirty day period referenced above in this Clause and if the Royalty Owner reasonably believes that the exercise of its rights under Subclauses (a) or (b) of this Clause would not allow recovery of the amounts owed to it in a reasonable period of time the Royalty Owner may enforce the lien referred to in Clause 7.01 (Royalty Owner's Lien) by taking possession of or using free of charge all or any part of the Grantor's interest in the Royalty Lands in all or any part of the production therefrom and equipment thereon and all rights, powers and privileges of such Grantor in connection with such interest until such default is fully rectified

VIII TITLE DOCUMENT ADMINISTRATION AND ENCUMBRANCES

8.01 Administration Of Title Documents And Permitted Encumbrances

The Grantor shall comply with all terms and conditions of the Title Documents including the payment of rentals, royalties and the performance of all things necessary to maintain the Title Documents in good standing and in full force and effect. This Clause shall not however obligate the Grantor to conduct any drilling, geophysical or geological operation for the Royalty Lands or to pay compensatory royalty to maintain a Title Document as it pertains to the Royalty Lands in full force and effect where the requirement to conduct such operation or to pay compensatory royalty may be avoided by the surrender of lands subject to the affected Title Document to the issuer thereof. The Grantor shall comply with all terms and conditions of any encumbrances agreed to be borne by the Grantor under the Agreement.

8.02 Title Document Correspondence To Be Sent To Royalty Owner

The Grantor shall provide the Royalty Owner in a timely manner with copies of material correspondence regarding continuation or grouping applications sent to the issuer of the Title Documents, notices to fulfill offset obligations, notices to rectify any default sent by the issuer of a Title Document or any other material decision required to be made pertaining to the maintenance of the Title Documents.

8.03 Responsibility For Additional Encumbrances

If the Working Interest of the Grantor is or becomes encumbered by any royalty overriding royalty, production payment or other charge of a similar nature other than the Overriding Royalty, the royalties payable to the issuer of the Title Documents and any encumbrance to be borne by the Grantor pursuant to either the Agreement or the agreement of the Parties, the Grantor shall be solely responsible for such additional encumbrance. In the event of any surrender or required assignment to the Royalty Owner provided for in this Royalty Procedure, such surrendered or affected interest shall be freed of any such additional encumbrance caused, suffered or created by or through that Grantor (or its predecessor in interest) at the sole cost and expense of the Grantor and the Grantor shall indemnify the Royalty Owner for any losses it may suffer as a result of the failure of the Grantor to fulfill the obligation to remove such additional encumbrance.

IX OPERATIONS AND LIENS

9.01 Operations Conducted In Proper Manner

The Grantor shall conduct all operations diligently in a good and workmanlike manner in accordance with good oilfield practice and in compliance with the Regulations and the provisions of the Title Documents. When the

Article X In this Article as well as Articles XI and XIII (as it affects first rights of refusal) a distinction is made between Overriding Royalties which are convertible and those which are not convertible. The rationale for the lesser rights afforded the non-convertible Overriding Royalty is that having elected to remain in an Overriding Royalty position at Payout (if there ever was a conversion right) the Farmor/Royalty Owner does not have the same level of interest in the area.

Clause 11.01

- (i) If the Grantor/Farmee earned subject to conditions subsequent the Abandonment provision of the Farmout Procedure would apply until the Grantor/Farmee removes those conditions. This Abandonment Article applies to Royalty Wells other than earning wells and to Completed earning wells which are proposed for Abandonment before Payout.
- (ii) Where there are multiple Working Interest owners, those Working Interest owners are given the first chance to take over the well pursuant to the Operating Procedure before the well is offered to the Royalty Owners. The authors believed this was appropriate given the Working Interest owners more active interest in the well at that point in time.
- (iii) Note that the Operating Procedure (a defined term) and the Royalty Procedure are parts of the same agreement. This paragraph does not address the sequence of events where multiple agreements are in force for the same lands. See Comment (i) for Clause 12.01.

Grantor hires contractors to conduct any part of such operations the Grantor shall supervise those contractors to the extent reasonably necessary to ensure that those contractors conduct their work in the same manner

9.02 Protection From Liens

For the Grantor's operations on the Royalty Lands the Grantor 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 Grantor and for materials supplied to the Grantor
- (b) keep the Royalty Lands free from liens and encumbrances resulting therefrom unless and to the extent there is a bona fide dispute with respect thereto
- (c) not permit any dues or claims from any Workers' Compensation Board or similar authority established under the Regulations to become in arrears and
- (d) if required by the Royalty Owner supply the Royalty Owner with satisfactory evidence of the payment of all claims and accounts including affidavits and statutory declarations to the effect that all claims and indebtedness have been paid

X INFORMATION TO ROYALTY OWNER

10.01 Pre Commencement Information

At least forty-eight (48) hours prior to the drilling of any Royalty Well on the Royalty Lands the Grantor shall

- (a) give notice to the Royalty Owner of the Grantor's intention to drill and
- (b) provide the Royalty Owner a copy of the plan of each well location survey the application for well licence and when available a copy of the well licence

10.02 Additional Information To Royalty Owners

If the Royalty Owner retains a right to convert its Overriding Royalty interest to a Working Interest under the Agreement this Clause shall apply from the date this Royalty Procedure comes into effect until the date upon which the Royalty Owner's right to convert its Overriding Royalty to a Working Interest ends

As between the Grantor and the Royalty Owner and to the extent that the Royalty Owner requests Article VII of the 1990 Operating Procedure (with the exception of Subclauses 701(a) 701(b) 701(c) paragraphs 702(i) and 704(a)(vi) Clauses 707 and 708) shall be incorporated herein by reference for operations on any Royalty Well on the Royalty Lands Nothing in this Clause shall make the Royalty Owner subject to any cost risk or expense of that operation

XI ABANDONMENT OF ROYALTY WELLS

11.01 Royalty Owner's Right To Take Over Well

If the Royalty Owner retains a right to convert its Overriding Royalty to a Working Interest under the Agreement this Article shall apply from the date the Royalty Procedure comes into effect until the date upon which the Royalty Owner's right to convert its Overriding Royalty to a Working Interest ends except to the extent that the Royalty Owner has the right to take over that well pursuant to the Agreement or the Schedule attached to the Agreement entitled Farmout Procedure

Clause 11 02 The corresponding provision in the Farmout Procedure has an Alternate allowing Abandonment costs to be netted out. The authors wished to reduce the number of Alternates in the Royalty Procedure and the mode of settling accounts contained in this Clause was thought to be the most appropriate for Royalty Wells.

Clause 11 03 Note that Capping is sufficient to cause an assignment of interest in the Spacing Unit as to the relevant zone. Contrast this with the corresponding provision in the Farmout Procedure. Again, the authors believed this was appropriate for Royalty Wells.

Clauses 11 04 This Clause is useful where there are multiple Royalty Owner Parties.

If there are multiple Grantor Parties and if a Grantor Party proposes to Abandon a Royalty Well on Royalty Lands the Grantor Party shall comply with the Operating Procedure and if that Royalty Well is still proposed for Abandonment thereafter the Grantor shall comply with this Article

If the Grantor intends to Abandon a Royalty Well located on the Royalty Lands the Grantor shall give notice of same to the Royalty Owner and shall supply the Royalty Owner with all information the Grantor is obligated to provide the Royalty Owner concerning that well and such other data from that well which may be reasonably required by the Royalty Owner in determining whether it wishes to exercise its rights pursuant to this Article Within twenty four (24) hours of receipt of the Grantor'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 Grantor's notice and information in all other cases the Royalty Owner may elect to take over that well Failure by the Royalty Owner to elect within the applicable election period to take over that well shall be deemed to be the Royalty Owner's concurrence with the Abandonment of that well The Grantor shall Abandon that well unless the Royalty Owner elects to take over that well pursuant to this Clause

11.02 Adjustment Of Accounts

If the Grantor assigns a well to the Royalty Owner pursuant to this Article the Grantor shall calculate the estimated net salvage value of the material and equipment assigned to the Royalty Owner The Royalty Owner shall pay the amount calculated within thirty (30) days of receiving an invoice for same If the Parties are unable to agree on any cost or value 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 (R.S.A. 1991 c. 43.1) as amended from time to time The Royalty Owner shall pay the Grantor the amount so determined within thirty (30) days of that determination

11.03 Effect On Grantor's Interest

If the Royalty Owner takes over a well pursuant to this Article the Grantor shall effective as of the date of the Royalty Owner's election to take over that well assign that well (including the material equipment and surface access rights relating thereto which the Royalty Owner wishes to utilize) to the Royalty Owner without warranty The Grantor shall be released from all obligations and liabilities accruing for the property assigned to the Royalty Owner pursuant to this Clause following the assignment That assignment shall not release the Grantor from any obligation which should have been performed by it or any liability which may have accrued to it prior to that assignment If the Royalty Owner Caps or Completes the well in zones contained in the Royalty Lands the Grantor shall assign to the Royalty Owner the Royalty Lands within the Spacing Unit for that well insofar as it relates to the zone Capped or Completed by the Royalty Owner and the Petroleum Substances therein effective as of the date of the Royalty Owner's election to take over that well

11.04 Operating Procedure Applies Among Royalty Owners

If more than one Party comprising the Royalty Owner acquire interests pursuant to this Article the well and the Royalty Lands assigned by the Grantor by virtue of this Clause shall be governed by the Operating Procedure as among those Royalty Owner Parties Those Royalty Owner Parties shall appoint one of them to be the initial Operator thereunder If one or more (but fewer than all) of the Parties comprising the Royalty Owner elect to take over a well proposed to be Abandoned pursuant to this Article that takeover and Completion shall be at the sole cost and expense of the Parties taking over the well shall be subject to the provisions of the Operating Procedure shall be deemed to be an independent operation under the Operating Procedure and Article XIV (LIABILITY AND INDEMNITY) shall apply mutatis mutandis between the Parties so taking over the well and the Parties comprising the Royalty Owner which elect not to take over that well In that event the amount (if any) paid to the Grantor pursuant to Clause 11.02 (Adjustment Of Accounts) 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

Clause 12 01

- (i) The first paragraph provides the sequence of events for a surrender where the Royalty Lands proposed for such surrender are subject to the Operating Procedure (a defined term) and the Royalty Procedure in a single Farmout Agreement. However, it does not address the sequence of events where the Grantor is bound by other agreements (and other operating procedures) to which the Royalty Owner is not a Party or of which the Royalty Owner may not even be aware. If the Agreement initially covered only a portion of the Working Interest (e.g. 50%) the Grantor must ensure that the time periods allow it to fulfill its individual surrender and abandonment obligations under its agreement with its original partners and this Royalty Procedure. The Grantor must also be aware of the effects of the Overriding Royalty on activities under that other agreement, such as proposing to surrender the Title Document back to the lessor, electing not to participate in either a title preserving or normal penalty type of well (e.g. indemnity under 801 of the Operating Procedure or payment of royalty when the Grantor goes penalty on an independent operation). See item (x) of the commentary for Clause 3 01 of the Agreement.
- (ii) The Royalty Owner can take over parts of the land proposed for surrender or expiry and allow other parts to go back to the issuer of the applicable Title Documents.
- (iii) Where a Party has both an Overriding Royalty and a Working Interest in lands subject to the Farmout Agreement, it could be dealing with surrender notices under both this provision and Article XI of the Operating Procedure.

Clause 12 04 Where there is an unabandoned well affecting the lands and zones proposed for surrender or expiry, this Clause ensures that well is dealt with. If the Farmee conditionally earned by Capping the Test Well, but later decided to surrender, inter alia, the Spacing Unit as to the Capped zone, the Farmout Procedure Abandonment Article applies to that Abandonment. If the Test Well was Completed (i.e. earning was unconditional) but before Payout, the Grantor decided to surrender the Completed zone Spacing Unit, the Royalty Procedure Abandonment Clause would apply. The Royalty Procedure would also apply to unabandoned Royalty Wells other than an earning well prior to Payout. If Payout had occurred and the Royalty Owner remained in an Overriding Royalty position or if the Grantor had unconditionally earned but the Overriding Royalty was never convertible, the Royalty Owner would not have the right to take over the well. Note, however, that even where the Royalty Owner has the right to take over a well, that right is only triggered by a total Abandonment. If the Grantor could comply with the Clause by Abandoning the zones affected by the surrender and Completing uphole, the Royalty Owner would not have the right to take over the well.

XII ROYALTY OWNER'S RIGHTS UPON SURRENDER OR EXPIRY

12.01 Notice Obligations On Surrender Or Expiry

If there are multiple Grantor Parties and if a Grantor Party proposes to surrender to the issuer of the Title Documents all or a portion of the Title Documents for Royalty Lands that Grantor Party shall comply with the Operating Procedure and to the extent those Royalty Lands are still proposed for surrender thereafter the Grantor shall comply with this Article

If the Grantor intends to surrender to the issuer of the Title Documents or to allow to expire all or a portion of the Title Documents for Royalty Lands the Grantor shall give notice (hereinafter referred to as the Surrender/Expiry Notice) to the Royalty Owner which Surrender/Expiry Notice shall specify the lands or zones subject to surrender or expiry at least twenty (20) days in advance of the earlier of

- (a) the date of surrender or expiry as the case may be or
- (b) the date for the performance of any obligation the non performance of which would result in the lapse termination forfeiture or cancellation of all or a portion of the Title Documents

The Royalty Owner shall have the right to elect by notice to the Grantor within ten (10) days after receipt of the Grantor's Surrender/Expiry Notice to acquire the Working Interest in all or any portion of the lands or zones affected by the Surrender/Expiry Notice

12.02 Concurrence In Surrender Or Expiry

To the extent that the Royalty Owner gives notice to the Grantor that it elects not to acquire all or any portion of the interests specified in the Surrender/Expiry Notice or if the Royalty Owner fails to give notice pursuant to the previous Clause the Royalty Owner shall be deemed to have consented to the relevant surrender or expiry and the Grantor may surrender or allow to expire the interests specified in the Surrender/Expiry Notice

12.03 Election To Acquire

If the Royalty Owner gives notice to the Grantor that it elects to acquire the interests in all or any portion of the interests specified in the Surrender/Expiry Notice the Grantor shall assign or cause to assign all of the Working Interest in such interest to the Royalty Owner without warranty effective as of the date the Royalty Owner elects to acquire such interest Such assignment however shall not release the Grantor from any obligation which should have been performed by it or any liability which may have accrued to it prior to that assignment If there are multiple Royalty Owner Parties and to the extent those Royalty Owner Parties did not elect to acquire the interests specified in the Surrender/Expiry Notice the Working Interest assigned to the Royalty Owner Parties electing to acquire those interests shall be free and clear of the Overriding Royalty held by the Royalty Owner Parties not so electing

12.04 Abandonment Of Wells On Lands In Surrender/Expiry Notice

If the interests subject to the Surrender/Expiry Notice include the Spacing Unit for a Royalty Well as to a zone for which a Royalty Well has been Capped or Completed the Grantor shall prior to or at the time it issues that Surrender/Expiry Notice (i) give notice proposing the Abandonment of that Royalty Well if the Royalty Owner retains the right to take over that well pursuant to this Royalty Procedure the Agreement or the Schedule to the Agreement entitled Farmout Procedure as applicable or (ii) commence Abandoning that Royalty Well at least as to the zones subject to the Surrender/Expiry Notice and thereafter diligently finish that Abandonment

12.05 Restrictions On Surrender

Notwithstanding the preceding Clauses of this Article the Royalty Lands proposed for surrender by the Grantor must be of such dimensions that the issuer of the Title Documents to which those lands are subject would be obligated to accept the surrender pursuant to the Title Documents and the Grantor may not propose the surrender of a portion of the Royalty Lands while an obligation exists with respect to those lands which cannot

Clause 13.01

- (i) While this Clause utilizes the corresponding provision in the Operating Procedure the first right of refusal would not apply to a non-convertible Overriding Royalty
- (ii) While the Overriding Royalty is still convertible and if the Operating Procedure used 2401B the first right of refusal would apply That is a reflection of the more active interest held by the convertible Overriding Royalty owner
- (iii) The first paragraph is needed to make Clause 2402 of the Operating Procedure applicable to the Overriding Royalty interest
- (iv) The fourth paragraph is needed where there are multiple Royalty Owner Parties or multiple Grantor Parties With respect to Grantor Parties this paragraph uses the same rationale as Article XI The other Grantor Parties have a common type of interest and thus should have the first chance to take over interests which a Working Interest owner wishes to dispose With respect to Royalty Owner Parties and given the approach taken with Working Interest Parties the authors believed that the fairest way to deal with a disposition by a Royalty Owner Party was to have the other Royalty Owner Parties have the first chance to take over that interest

be avoided by the surrender or quit claim of those lands to the issuer of the Title Documents to which they are subject. If the Royalty Owner elects to acquire only a portion of the Royalty Lands proposed for surrender, the Royalty Owner shall select those lands in such dimensions so that the lands remaining are of such dimensions that the issuer of the Title Documents would be obligated to accept the surrender of the remaining lands pursuant to the Title Documents.

XIII ASSIGNMENT ROYALTY LANDS

13 01 Application Of Operating Procedure Provision

If a Schedule entitled Operating Procedure is attached to the Agreement Article XXIV (DISPOSITION OF INTERESTS) of the Operating Procedure is incorporated by reference herein with the following amendments:

- (a) If a Royalty Owner intends to assign all or a portion of its Overriding Royalty interest and if that interest is convertible to a Working Interest pursuant to the Agreement which right has not accrued at that time, the Working Interest to which that Overriding Royalty interest may be converted shall be used to calculate the net hectares being disposed of for the purposes of Clause 2402 (Exceptions to Clause 2401) of the Operating Procedure.
- (b) If Alternate B is utilized in Clause 2401 (Right To Assign, Sell Or Dispose) of the Operating Procedure and if the Royalty Owner does not have the right to convert its Overriding Royalty interest to a Working Interest pursuant to the Agreement, Alternate A for that Clause 2401 (Right to Assign, Sell or Dispose) shall be deemed to have been chosen for the purposes of this Royalty Procedure.
- (c) If Alternate B is utilized in Clause 2401 (Right To Assign, Sell Or Dispose) of the Operating Procedure and if the Royalty Owner retains its Overriding Royalty when the right to convert to a Working Interest accrues, effective as of the date when the Royalty Owner ceases to have a right to convert its Overriding Royalty to a Working Interest, Alternate A shall be deemed to replace Alternate B in that Clause 2401 (Right To Assign, Sell Or Dispose) for the purposes of this Royalty Procedure.
- (d) If Alternate B is utilized in Clause 2401 (Right To Assign, Sell Or Dispose) of the Operating Procedure, the following Subclauses shall apply for the purposes of this Royalty Procedure:
 - (i) If the Royalty Owner comprises more than one Party and one of those Parties intends to assign all or any portion of its Overriding Royalty interest and Clause 2402 (Exceptions to Clause 2401) of the Operating Procedure does not apply so as to exclude that assignment from being subject to Clause 2401 (Right to Assign, Sell or dispose) of the Operating Procedure, the Royalty Owner Party intending to make that assignment shall first comply with the Operating Procedure as between itself and the other Royalty Owners only. If the other Royalty Owner Parties do not exercise their rights to acquire that Overriding Royalty interest, the Royalty Owner which intends to make that assignment shall then comply with the Operating Procedure as between itself and the Grantor only.
 - (ii) The provisions of paragraph (i) above shall apply mutatis mutandis to the circumstance where there is more than one Grantor Party and one of those Parties intends to assign all or any portion of its Working Interest in the Royalty Lands.

If no Schedule entitled Operating Procedure is attached to the Agreement Article XXIV (Disposition Of Interests) of the 1990 Operating Procedure is incorporated by reference herein, Alternate A of Clause 2401 (Right To Assign, Sell Or Dispose) and Alternate B of Clause 2404 (Recognition Upon Assignment) shall apply.

XIV LIABILITY AND INDEMNITY

14.01 Grantor's Responsibility

The Grantor shall

- (a) be liable to the Royalty Owner for all losses, costs, damages and expenses whatsoever (whether contractual or tortious) which the Royalty Owner may suffer, sustain, pay or incur, and
- (b) in addition, indemnify and hold harmless the Royalty Owner 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 Royalty Owner, 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 Grantor with respect to operations or activities conducted by it or on behalf of it, provided that the Grantor shall not be liable to, or be required to indemnify and save harmless the Royalty Owner 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 Royalty Owner.

14.02 Royalty Owner's Responsibility

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

XV CONFIDENTIAL INFORMATION

15.01 Confidentiality Requirement For Grantor And Royalty Owner

Clauses 1801 and 1803 of the 1990 Operating Procedure shall apply herein mutatis mutandis to both the Grantor and the Royalty Owner until the later of

- (i) the date of expiry of the term specified for the area of mutual interest provision of the Agreement, if applicable, or
- (ii) the date when the Royalty Owner ceases to have a right to convert its Overriding Royalty to a Working Interest pursuant to the Agreement, if applicable.

Upon that date, if applicable, only the Royalty Owner shall be bound by this Article to the extent the Royalty Procedure applies to that information. If the Agreement does not contain an area of mutual interest provision or a right on the part of the Royalty Owner to convert its Overriding Royalty to a Working Interest, only the Royalty Owner shall be bound by this Article.

XVI ADDRESSES FOR SERVICE OF NOTICES

16.01 Addresses For Notices

The address for service of notices hereunder of each of the Parties shall be the addresses specified in the Operating Procedure. If no Schedule entitled Operating Procedure is attached to the Agreement or if the

addresses for service of notices in the Operating Procedure do not refer to all Parties of this Royalty Procedure
the addresses for service of the Parties for which no address for service of notices is so specified are