CAPLA
Canadian Association of Petroleum Land Administration

Canadian Association of Petroleum Landmen

MAY 1, 2011

TO THE CAPLA AND CAPL MEMBERSHIP

RE: LETTER OF ENDORSEMENT FOR THE SEGREGATION PROTOCOL

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We hereby advise our membership that the current board of directors of both CAPLA and CAPL endorse the Segregation Protocol (Version: CAPLA 2011) and strongly encourage its adoption by you and your companies, when formally released on June 1, 2011, as the new industry standard for the administration of segregated land interests and the service of notices of assignment.

Under the capable leadership of Michelle Radomski, the Segregation Protocol was developed after an exhaustive review of options by a team of experienced land and legal professionals (including Jim MacLean, principal draftsman of the 1990 and 2007 CAPL Operating Procedures) and is soundly based on the fundamental principles of privity and novation in contract law, where only the concerned parties having an interest in the lands need to be addressed regarding an assignment of segregated interests. The "code of conduct" established by the Protocol offers Industry a very efficient and consistent set of rules to be followed for serving notices of assignment to the third parties to our land agreements.

Industry will benefit greatly from the implementation of this Protocol through the elimination of record management for non-interest lands, fewer notice rejections and reworks and speedier redirection of joint account billings to new parties. We therefore call upon everyone in Industry to immediately start working in cooperation with your peer groups to expedite the integration of this Protocol into our everyday business practices.

Yours sincerely,

Melanie Storey
President, CAPLA

James Condon
President, CAPL

Cc: Gary Leach, SEPAC Executive Director
David Collyer, CAPP President
Sean Nicholson, CAPPA President

**SEGREGATION PROTOCOL**
**June 2011 Release**

**NOTICE TO INDUSTRY**

## THE ISSUE OF SEGREGATION

Soon after the introduction of the 1993 CAPL Notice of Assignment Procedure, CAPLA (Canadian Association of Petroleum Land Administration) recognized that Industry was faced with a major challenge when trying to serve a notice of assignment ("NOA") to third parties for the disposition of segregated interests under our land agreements.

Segregation of land interests has been the outcome of prolific acquisition and divestiture activity, and Industry has held contradictory viewpoints regarding which parties are to be served with a NOA.

- Those that have an interest in the lands assigned, or
- Those that have an interest in all lands subject to the agreement

The resulting inconsistency in the administrative practices employed by Industry is very problematic and ultimately unsustainable in our current business environment where management's overall expectation is that we should be enhancing our efficiency and effectiveness. Land Administration resources are being spent on rejecting and revising NOA's and unnecessarily delaying the proper recognition of new parties under our agreements based on a very technical interpretation of the definition of third parties in the Notice of Assignment Procedure. Surely our management would prefer to have its Land Administration resources dedicated to tasks that actually add shareholder value instead of spent debating over whom should be named as third parties to a NOA.

The Segregation Committee was originally formed by CAPLA in 1995 to evaluate the administrative inefficiencies and the business consequences associated with this issue and to identify a solution. Work on this project was put on hold in 1999 awaiting the redraft of the Segregation Article XIII in the now 2007 version of the CAPL Operating Procedure. The project was started up again in early 2010 and the final findings and recommendations of the Segregation Committee for a solution to the issue of segregation are outlined below.

## SOLUTIONS INVESTIGATED

Three alternative solutions were considered:

- Industry Agreement
  - Pro: one time application to append segregation provisions to existing agreements
  - Con: would not align with signatories to NOA Procedure; doesn't deal with new agreements and may not adequately address unique circumstances such as an area of mutual interest

- Agreement Provisions or Procedure
  - Pro: segregation specifically dealt with in every agreement by incorporating standard clauses or referencing a formal procedure that would create "mirror image" agreements for each segregated land interest block (same principle as Article XIII of CAPL Operating Procedure)
  - Con: in addition to including provisions in all new agreements, would need to go back and amend all existing agreements; also, the concept of separate agreements being

arbitrarily created to govern each segregated block of land interests could result in contract record and file duplication, confusion over the identification of multiple agreements all split from and having the same date and parties as the original agreement, proliferation of NOA's for split agreements and this approach may not properly deal with extraordinary contract interests that cannot easily be segregated with the lands, such as areas of mutual interest, etc.

- Industry Protocol **(RECOMMENDED SOLUTION)**
  - Pro: code of conduct to deal only with the serving of a NOA to only those parties having interests in the lands assigned, with little to no risk of legal or economic ramifications
  - Con: may not necessarily have buy in from everyone, so may still need a contractual solution to address privity of contract concerns for those parties unwilling to modify their practice without an amendment to the agreement

## FINDINGS

The Committee found that, in contract law, an agreement can exist only amongst the "concerned parties having an interest in the same matter", and novation is an agreement by the concerned parties to replace an old contract with a new one which terminates the old contract. When Industry adopted the Notice of Assignment Procedure, it essentially agreed that novation under the Master Agreement would be deemed to have occurred simply through the service of a NOA to the appropriate third parties, so long as no such party objects to the NOA within the specified period of time for consent. This procedure eliminated the need to have all the parties go the cumbersome and lengthy exercise of executing the old style assignment and novation agreement and distributing counterpart execution pages to otherwise satisfy the contractual requirement for the intended novation to become effective. Therefore, for novation to occur with the service of a NOA, it is not so important that it be served to all the parties holding an interest in all the lands as originally governed by an agreement; but, more so that it be served to no less than those "concerned parties" having the contractual right to object to the NOA.

Additionally, except in the case of a small minority of those agreements that contain extraordinary contractual rights not related directly to a party's interest in the governed lands (such as an area of mutual interest,), the Committee could not identify any other instances where the failure to serve a NOA to a party having no interest in the lands being assigned would negatively or adversely affect that party's proper right to its land or real economic interest under that agreement. Furthermore, even if all parties to the agreement were to be served with a NOA today where lands rights were being segregated in the case of an agreement having such extraordinary type contractual rights, the parties would still need to specifically address how those extraordinary rights would be held amongst all the differing parties going forward.

In the end, the Committee's final finding was simply this: "segregation of contractual rights happens automatically at law when a new party is novated into an agreement for only a part of the original whole, as if the parties in common have entered into new, separate agreements"; and, the problem of segregation exists only because all of Industry has failed to agree on how to align our administrative practices with this basic legal concept.

## FINAL RECOMMENDATION

Therefore, based on the pros and cons of each of the solutions considered and the foregoing findings, the Segregation Protocol was developed by the Committee to formalize a "code of conduct" to be followed by Industry when dealing with segregated interests to allow everyone to conduct their business in the same, consistent manner based on the legal principle of novation. However, the recommended protocol does not attempt to complicate our administration with the creation of multiple agreements to govern segregated lands; but, instead, provides us with a common-sense guide for everyone in Industry to follow to reduce our administrative burden and consistently serve NOA's to only those third parties having an interest in the lands being assigned. Article XIII and Clause 24.04B have also been redrafted in the 2007 CAPL Operating Procedure to enforce this new approach.

A significant number of companies have already been conducting their business in the same manner as prescribed by the protocol; and, based on the fundamental principles of novation, it is hugely inefficient and ineffective for any of the other companies to continue to resist adopting the protocol into their standard administrative practices. If Industry immediately begins to work together, in cooperation, to facilitate and follow the protocol, all of us will quickly see our time and effort much better spent on more enjoyable and meaningful job tasks, not to mention alleviating the excess paperwork and accounting issues and reworks currently being experienced because of disputes over third party recognition under our agreements.

Until the protocol does become recognized as a standardized Industry practice, it may be necessary in some cases to have the protocol formally incorporated into a land agreement to help expedite the transition, so templates have been developed and are included in this package.

The rest of this package entitled "Segregation – The Issue and The Solution" provides you with:

a) a more in-depth introduction to the issue of segregation, the current contractual issues affecting notices of assignments, guidelines for identifying and dealing with the issues that arise from segregation and the procedures to be followed when serving a NOA in accordance with the recommended protocol;

b) the protocol that the Segregation Committee of CAPLA recommends that Industry adopt; and

c) a "template clause" and "template addendum" to incorporate the protocol by reference into new agreements and old agreements if necessary for those parties that require a specific contractual amendment to modify their administrative practices.

Any questions with regard to the issue of segregation, the recommended protocol or this package can be directed to:

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## ACKNOWLEDGEMENTS

The Segregation Committee was first headed up by Lynn Gregory as Chairman in 1995, along with Michelle Radomski, Shelly Wilson, Rebecca Nowell, Mari-Anna McCargar and George Green; amongst others that joined in from time to time to provide their invaluable expertise, such as Jim McLean, Jay Park, Jonathan Chapman and Ted Weryshko, just to name a few. Although this initial group was disbanded in 1999, when the project fell into a hiatus awaiting the redrafting of the 1990 CAPL Operating Procedure, all these individuals were instrumental in the early development of the concepts that lead to the Segregation Protocol.

The project was resumed again in 2010 by Michelle Radomski, as acting Chairman, with the assistance of Lynn Gregory, Jim McLean and Paul Negenman, to finalize the Segregation Protocol and prepare this package for delivery to Industry. Thank You for everyone's help and support!

*It is now up to Industry to take ownership of the Segregation Protocol and make it succeed!*

# SEGREGATION

## THE ISSUE AND THE SOLUTION

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## THE ISSUE AND THE SOLUTION

## SECTION I – INTRODUCTION TO SEGREGATION

### What Is Segregation

To "Segregate" means to set apart, separate or partition from the rest.

Segregation of the parties' interests in land occurs automatically when the interests of the parties in any portion of the land under an agreement cease to be owned either by: (a) all the parties in the same percentages, or (b) the same parties as in the rest of the land.

Segregation of the parties' rights, obligations and liabilities under an agreement can occur only if all the parties agree to novate a new party into an agreement in the place of another with respect to only a portion of the lands so that the provisions of the agreement will apply separately and independently among differing parties.

### The Segregation Issue

Since the introduction of the 1993 CAPL Notice of Assignment Procedure ("NOA Procedure"), Industry has not been able to agree on a consistent interpretation of which parties should be served with a notice of assignment ("NOA") once land interests have been segregated. Certain companies insist that only those parties to the lands need to be served with a NOA and others insist that all parties to the agreement must be served. As a result, administrators expend a lot of extra unwarranted time and effort trying to track and identify the correct parties to an agreement and revising NOA's to meet other parties' criteria for third party notice. Consequently, there is often significant delay in having new parties recognized under an agreement. In some cases, the notice will never be accepted as correct by all the parties, and therefore never becomes binding upon them for recognition of the new party. Without proper novation of the new party into the agreement, a number of concerns and issues arise, such as:

i) the assigning party's certainty of absolute release from its contractual obligations and liabilities to the other parties under the agreement remains in question, such as for the joint account;
ii) joint venture accounting consequently gets bogged down with billings going to the last recognized party under the agreement instead of the new party holding the beneficial interest in the lands; and
iii) a party not properly recognized under the agreement is potentially faced with title curity issues in satisfying a buyer's due diligence if it tries to sell its interest at some later date.

See Section II - "Segregation Illustrated" for an example of how segregation can affect notices of assignment over time, depending on whether parties to the agreement or only parties to the lands are served with notices of assignment.

The issue of segregation has been borne from the concept of "privity of contract" at law. Being privy is loosely defined as "being one of the parties having an interest in the same matter". By definition, the word "novation" means; "a contract agreed upon by the concerned parties to replace an old contract with a new one which terminates the old contract". Therefore, the

introduction of a new party by novation effectively creates a new agreement amongst the remaining parties holding the common interests in any particular parcel of land.

The NOA Procedure was intended to effect novation under an agreement by service of a NOA in lieu of the "concerned parties" having to enter into an assignment and novation agreement in each instance of a disposition of interest. However, because the NOA Procedure was also drafted based on the notion of privity, it states that a NOA is to be served to the "Third Parties", being defined as "the parties to the Agreement". It was unfortunately not made clear in the NOA Procedure that the definition of the "Agreement" would be altered to mean one or more new agreements (and, as a result, differing Third Parties) with the segregation of the parties' land interests by novation.

Notwithstanding the fundamental concept of novation, whereby the parties may be deemed to have entered into new and separately governing agreements among only those parties having common land interests when segregation occurs, there are some extraordinary contractual provisions where such a simplistic interpretation and application may be problematic. There are various other types of contractual rights, liabilities and obligations governed by our land agreements that may be appurtenant, but not necessarily directly tied, to a party's specific interest in the land, such as an area of mutual interest or ownership in common facilities, etc.

The majority of our land agreements do not adequately address this issue, except to the extent of Article XIII in the CAPL Operating Procedure when incorporated into the agreement. This provision allows for operations to be conducted only between the joint operators of the lands when segregation occurs "as if they are parties to a separate Operating Procedure". However, prior to the new 2007 version of the CAPL Operating Procedure, this provision, if explicitly interpreted, does not act to segregate any terms or conditions governing the parties' rights or obligations under the head agreement (or its other schedules) that may apply independent of the Operating Procedure. Article XIII in the new 2007 version has been amended to extend the application of segregation beyond the Operating Procedure to the head agreement.

## The Segregation Solution

While concerning itself with the issue of privity of contract when serving a NOA related to segregated land interests, those parties have unfortunately overlooked the more pragmatic question of what is at risk and what damage would be suffered by any party not served with a NOA where that party holds no interest in the lands being assigned. In most circumstances it would seem there are more administrative consequences than any tangible contractual, legal or economic ramifications when trying to apply this concept to all the parties to an agreement, jointly and severally, after the joint interests initially held by those parties under the agreement have become segregated and later held among differing parties.

In looking at possible alternatives to address this issue, the Segregation Committee did however recognize that, due to those few extraordinary provisions in our land agreements that deal with contractual interests, rights, obligations or liabilities not directly related to the parties' land interests, a generic contractual solution based strictly on the concept of novation would have to be used with extreme caution if those types of agreements as a whole were to be considered terminated and replaced with new agreements having mutually exclusive application to each segregated block of land or to only certain parties.

Therefore, the Segregation Committee concluded that the most practical solution is for Industry to accept and follow a common protocol which recognizes that, when joint land interests become segregated under an agreement, all parties to the same agreement are no longer "concerned parties having an interest in the same matter" when pertaining only to the matter of a NOA.

The rest of this package goes on to present the Segregation Protocol that the Segregation Committee is recommending be adopted by Industry for serving NOA's based on the exact same concept that has been endorsed and practiced by Industry for many years now in its acceptance and application of Article XIII of the CAPL Operating Procedure for conducting operations on segregated lands.

## The Segregation Protocol

The Segregation Protocol is set out in Section IV and is intended for parties to administer their agreements as if each block of land were governed by a separate agreement among only those parties holding an interest in that block for the purpose only of serving a NOA.

Other than for the purpose of serving NOA's, the Segregation Protocol does not go so far as to suggest that the agreement is actually severed in its entirety; however, it will still be necessary, at or prior to the time any NOA is served, to adequately address any of those extraordinary contractual interests, rights, obligations or liabilities that may then be held differently among the parties as a result of the segregation of land interests.

See Section III – "Segregation Protocol Guidelines and Procedures" for examples of some of the extraordinary contractual provisions that may need to be addressed by the parties when segregation will result from an assignment of interests, whether following the Segregation Protocol or not. The guidelines also offer assistance on how you might want to manage your land records, prepare your notices of assignments, etc. to get full benefit from adopting the Segregation Protocol.

If all parties can agree to adopt and follow the Segregation Protocol, their administrative work effort for tracking third party changes and serving NOA's should be immediately and significantly reduced without having to generate any more paperwork to amend their existing agreements. For any parties that may still require a provision in their agreements to formally incorporate the Segregation Protocol, templates have been prepared. See Section V of this package for: i) "Template Segregation Protocol Clause" for new agreements; and, ii) a "Template Segregation Protocol Addendum" for old agreements.

## SECTION II – SEGREGATION ILLUSTRATED

The following illustration shows how segregation of land interests can affect the administration of an agreement over time for each scenario in a chain of assignments where: (A) all parties to the agreement are served with notices of assignment in strict compliance with the NOA Procedure; or (B) only those parties having an interest in the lands affected by an assignment are served with notice pursuant to the Protocol proposed by the Segregation Committee as presented in this package.

EXAMPLE: Master Agreement between Company A and B to govern Sections 1, 2 and 3 as to a 50% WI each

<table>
<tr>
<td colspan="2">Scenario #1<br>Party A sells its 50% interest in Sec. 1 and 2 to Party C</td>
<td colspan="2">Scenario #2<br>Party B sells its 50% interest in Sec. 2 to Party D</td>
</tr>
<tr>
<td>Sec. 1<br>A - 0%<br>B – 50%<br>C – 50%<br><br>(A) All Parties to the Agreement Served Notice<br>Party A serves its NOA to Party B and would have to continue maintaining its land records to track the interests of all parties in Sec. 1, 2 & 3 to properly serve notice of any future assignment of its only remaining interests in Sec. 3.</td>
<td>Sec. 2<br>A - 0%<br>B - 50%<br>C - 50%<br>Sec. 3<br>A - 50%<br>B - 50%<br><br>(B) Only Parties in the Lands Served Notice<br>Party A would serve its NOA to Party B, but it would only continue to maintain its land records to track the interests of parties in Sec. 3.</td>
<td>Sec. 1<br>B - 50%<br>C - 50%<br><br>(A) All Parties to the Agreement Served Notice<br>Party B serves its NOA to both Party A and C, and would have to continue maintaining its land records to track the interests of all parties in Sec. 1, 2 & 3 to properly serve notice of any future assignment of its only remaining interests in Sec. 1 or 3.</td>
<td>Sec. 2<br>B - 0%<br>C - 50%<br>D - 50%<br>Sec. 3<br>A - 50%<br>B - 50%<br><br>(B) Only Parties in the Lands Served Notice<br>Party B would serve its NOA to Party C only and it would only continue to maintain its land records to track the interests of parties in Sec. 1 & 3.</td>
</tr>
<tr>
<td colspan="2">Scenario #3<br>Party A assigns 25% of its interest in Sec. 3 to Party E</td>
<td colspan="2">Scenario #4<br>Party B sells its 50% interest in Sec. 1 to Party F</td>
</tr>
<tr>
<td>Sec. 1<br>B - 50%<br>C - 50%<br><br>(A) All Parties to the Agreement Served Notice<br>Party A serves its NOA to Party B, C and D.</td>
<td>Sec. 2<br>C - 50%<br>D - 50%<br>Sec. 3<br>A - 25%<br>B - 50%<br>E - 25%<br><br>(B) Only Parties in the Lands Served Notice<br>Party A would serve its NOA to Party B only.</td>
<td>Sec. 1<br>B - 0%<br>C - 50%<br>F - 50%<br><br>(A) All Parties to the Agreement Served Notice<br>Party B serves its NOA to Party A, C, D and E, and would have to continue maintaining its land records to track the interests of all parties in Sec. 1, 2 & 3 to properly serve notice of any future assignment of its only remaining interests in Sec. 3.</td>
<td>Sec. 2<br>C - 50%<br>D - 50%<br>Sec. 3<br>A - 25%<br>B - 50%<br>E - 25%<br><br>(B) Only Parties in the Lands Served Notice<br>Party B would serve its NOA to Party C only and it would only continue to maintain its land records to track the interests of parties in Sec. 3.</td>
</tr>
</table>

## SECTION III – SEGREGATION PROTOCOL GUIDELINES AND PROCEDURES

The following guidelines and procedures are intended to ensure the consistent and proper implementation and application of the Segregation Protocol for the purpose of serving a NOA pursuant to the NOA Procedure, and to offer suggestions on how to address some of the more extraordinary contractual terms and conditions when interests become segregated.

Although the Segregation Protocol will ease administration with respect to notices of assignments, it is important to bear in mind the impact segregation will have on certain other operational or contractual matters; for example, zonal splits (rights to take-over a wellbore upon notice of abandonment/surrender), areas of mutual interest, ownership of joint production facilities, etc. These types of "residual" interests, rights, liabilities and obligations do not inherently segregate with the land interests by virtue of a NOA --- whether or not a NOA is to be served traditionally to all the parties to an agreement or only to the parties having an interest in the assigned lands pursuant to the Segregation Protocol -- so they need to be separately addressed, and preferably in advance of sending out the notice, to clarify the resulting relationship of the parties under the agreement with respect to these extraordinary matters when their land interests segregate.

### Area Of Mutual Interest

An area of mutual interest (AMI) is a contractual (contingent) right to participate in a future acquisition of lands, usually in the vicinity of existing lands, but is not necessarily assignable (in whole or in part) with an assignment of a partial interest in the existing lands. Therefore, the AMI can be problematic when the original parties' interests in the existing lands become segregated. To address this issue, it would be advisable for an assigning party to clearly set out in the NOA exactly what rights it is assigning in both the joint lands and the AMI lands governed by that agreement. It's not likely that segregation will frequently affect AMI's with short terms. However, if the AMI has a longer residual term or this approach is not a practical solution for the parties, it may become necessary to enter into a new AMI agreement apart from the agreement governing the lands, or to re-negotiate the term of the AMI under those older agreements that did not contemplate a termination date.

### Penalty For Non-Participation In An Operation

Segregation occurs with a change to a party's' interest in land. Where a production penalty is applicable for non-participation in an operation on the land, a party's interest in land does not change, but that party's interest in the land is subject to a penalty applied to its working interest share of production. Segregation of the agreement would not occur in this circumstance. This is different than the forfeiture of a party's interest in lands because of non-participation in a title preserving well where segregation would come into effect.

### Net Carried Or Net Profit Interest Accounts

Where there are provisions for a net carried or net profit interest account, segregation of the parties' interests could cause significant administration and accounting problems. It is recommended that the assignment clause in any such agreement be drafted to prohibit an assignment of only a portion of a party's interest to the extent that the parties' rights or obligations regarding the account would become segregated. Either the disposing party would have to act as trustee and hold the assigned land interests in trust for its acquiring party until a payout has occurred, if applicable, or all the effected parties would have to agree on how to re-allocate the revenues and costs to be contributed to the account for each of the Segregated Blocks.

## Operatorship

A change of operator is not effected by a NOA. If the assigning party is operator and wants to transfer operatorship to the acquiring party it must comply with the specific provisions of the agreement for change of operator.

## Ownership Of Joint Facilities

There are circumstances when common use facilities governed under an agreement will be located on lands that become segregated and owned by differing parties or in differing percentages; i.e. well 1-2 and 3-4 are serviced by a common battery all owned by Company "A" 50% and Company "B" 50%. Company "A" assigns half of its interest (25%) to Company "C" in well 1-2 only. How now are the operating expenses at the common battery to be shared between Company "A", "B" and "C" for production from the two wells. If the agreement contains any operating procedure older than the 1990 CAPL Operating Procedure, then the agreement likely does not have provision for operation of joint facilities other than the equipment immediately appurtentant to a single well (i.e. wellhead compression, tie-in flowlines, etc.). Therefore, in these cases, a separate ownership and operating agreement should already exist for any common use facilities -- if not, there should probably be one! In the case of the 1990 and 2007 CAPL Operating Procedures, the provisions of Article XIII apply to production facilities "mutatis mutandis". In other words, if joint interests in the lands change, then the related facility interests are deemed to be governed under a separate operating procedure. However, problems may still arise from not having properly defined the joint ownership of this facility as a result of a segregation of the land interests (i.e. who now owns how much interest in the common facilities, who has priority to, and will there be third party fees associated with, use of capacity in excess of a party's proportionate interest in the facilities, etc.?). So, even in some of these cases, a separate ownership and operating agreement may be warranted for the proper governance of any common use facilities as soon as the land interests become segregated.

## Ownership Of Wellbores

Ownership of a wellbore is typically connected to the ownership of the parties in the petroleum and natural gas rights into which the well was originally drilled and completed for purposes of production. However, that wellbore is also inherently associated with any other zones penetrated up-hole of the targeted zone so long as all those zones are held in common by the same parties. Normally, the parties would want the ownership in a wellbore transferred with any petroleum and natural gas rights that are being produced from that well at the time, such that an assigning party retaining any petroleum and natural gas rights in zones up-hole of the producing zone(s) would have no ownership in that wellbore in the eventuality that another party proposes to use that well for operations in those up-hole zones at some later date. If the well has not yet been completed, parties would usually expect the wellbore to continue to be owned by the joint interest parties in the deepest penetrated zone that is not abandoned. If a party intends to assign its ownership in some, but not all, zones penetrated by a wellbore, the parties are best advised to address any exceptions to these standard outcomes at the time of the assignment in the context of their particular circumstances (for example, a quit claim, wellbore conveyance or some other similar type of document or arrangement may be necessary amongst the parties, in addition to a NOA, to address each party's rights for access or use of the wellbore, the liabilities for zonal abandonment, etc.).

## Pooling / Unitization

Pooling agreements (where the working interests held by the parties in the respective lands are not cross-conveyed) and unitization agreements provide for the combination and sharing of

production only, and do not result in a change to the working interests in the land contributed by a party. Therefore, the parties' land interests typically continue to be held and governed under a separate operating agreement. In most cases, then, if the interests of a party in the contributed lands become segregated under the operating agreement, there would not be any segregation of interests under the pooling or unitization agreement. Instead there would be an assignment of either the entire, or a percentage of the entire, participating interest of the assigning party in the pooled or unitized lands as a whole. For example, if a party holds a 50% working interest in the north half of a section that was pooled with other parties' interests in the south half, that party would have 25% pooled interest only in respect of the production obtained from the entire section. If that party then sells 50% of its 50% working interest in the north half, it would then be assigning 50% of its entire 25% pooled interest under the pooling agreement.

## Effective Date of Segregation

In the event segregation occurs as a result of an assignment of interest in accordance with the NOA Procedure, the third parties are to recognize a new party to the head agreement, and therefore the segregation of the interests, as of the binding date of the NOA; or, in any other case, as of the date that a party's assignment, forfeiture or surrender of interest becomes effective pursuant to the provisions of the agreement. [NOTE: caution should be exercised when determining whether segregation has occurred in the case of the title preserving well provisions of the CAPL Operating Procedure, as the outcomes vary depending on the version. Forfeiture of land interests could potentially occur in combination with an immediate and future contingent event, and may be delayed, amended or void in certain situations where subsequent operations are carried out or new well information is obtained.

When any assignment of interest occurs in accordance with the NOA Procedure, the Assignor is to act as trustee and agent for the Assignee with regard to all matters related to the agreement and the assigned interests prior to the binding date of the NOA.

## Amendments To A Segregated Agreement

Many land information systems record the key contract terms and conditions (i.e. CAPL Operating Procedure or PASC Accounting Procedure) at the agreement header level; so it could become problematic trying to track and record changes to any terms and conditions that might result from one or more subsequent amending agreements made between the differing parties in the various Segregated Blocks. In these circumstances, particularly for older agreements with many splits, the parties may wish to be proactive by entering into new superseding agreements amongst the parties for each of the Segregated Blocks and incorporating newer versions of the CAPL Operating Agreement or PASC Accounting Procedure. Alternatively, for simpler scenarios, a new electronic skeleton file could be created to link the revised terms and conditions for those particular Segregated Blocks with a reference back to the original physical land file.

## Setting Up And Maintaining Files And Records

It is entirely up to each company to decide how to set up and maintain its files and electronic records when land interests segregate under an agreement. However, most companies already use subs or splits in their electronic contract and lease records to keep track of each block of land that has differing parties or differing party interests. Therefore, since the Segregation Protocol requires that the assigning party identify and serve notice only to the other parties holding an interest in the lands being assigned, no additional administrative effort should be required; in fact, administration should be simplified by then having to maintain only those land record subs or splits in which a party continues to hold an interest.

## Managing Segregated Title Document Liabilities and Obligations

If the serving of a NOA will result in the segregation of interests under a Title Document, whereby the party responsible for maintaining that Title Document will no longer have an interest in common with the assignee with respect to the assigned interest, then a trust agreement should be entered into between that managing party and the assignee party to govern their future relationship regarding that Title Document. In particular, those parties must agree on how any obligations and liabilities shall be handled, such as apportionment and payment of rentals, submission of continuation applications, etc. The trust agreement should incorporate the 1993 CAPL Assignment Procedure to facilitate any subsequent assignments of those parties' obligations, liabilities or rights under that trust agreement.

## Procedure for Serving Notices

a) To ease administration, reduce paper and avoid unnecessary handling of multiple notices, the Segregation Protocol allows an assigning party to serve one NOA covering more than one Segregated Block so long as (i) it is disposing of an interest under all of such separate Segregated Blocks that, when combined, cover all of its interests under that agreement; or (ii) that party identifies clearly in the NOA each Segregated Block to which the NOA pertains and the interest being assigned in each such block. Accordingly, a party receiving such a NOA will not have reason to reject that notice, provided that those other parties with which it holds common interest in each applicable Segregated Block are included in the list of Current Third Parties.

b) To clearly identify whether a party is assigning all or a percentage of its interests in certain Segregated Blocks, or its entire interest in all the Segregated Blocks under an agreement, an assigning party who will continue to hold interests in other Segregated Blocks which are not being assigned should always select Option B and specifically set out the lands and interests being assigned. This is recommended even though the assigning party may think it is assigning its entire interest in all those Segregated Blocks which it holds in common with those third parties to receive that notice, and where the Segregated Blocks in which it is retaining an interest are believed to be held in common with different parties (see Scenario 2 illustrated on the next page). If a third party receives the notice with Option A selected, intending to give notice that all of the assigning party's interest is being assigned only in the Segregated Blocks held in common with that third party, the third party could mistakenly conclude that the party has assigned its interest in other Segregated Blocks under the agreement where that third party might be a silent unrecognized party, etc. The land reference at the header of a NOA is meant only to help identify the Master Agreement; so an omission of lands from that reference should not be expected to mean an exclusion of those lands from the assigned interests when Option A is selected. Furthermore, there is no harm done if the assigned interests set out under Option B happen to be the only interests a third party shows in its records as held by the assigning party – its records would still be correctly changed to reflect the assignment of all commonly held Segregated Blocks.

c) If a party is assigning only a portion of its interests in any lands, the assigned interests should be described such as: "50% of Assignor's 50% working interest (being a net undivided 25% WI) in and to the specified lands or in the entire agreement". When assigning an entire interest, avoid making reference to only the percentage interest being assigned. For example, simply stating that the assigned interest is "30% in the described lands", could be incorrectly interpreted by a third party to mean the Assignee is being assigned only 30% of the Assignor's 30% working interest (a net 9%WI), or

alternatively clearly specify that the assigned interest is "100% of the Assignor's 30% working interest" or "the Assignor's entire 30% working interest".

d) In advance of serving a NOA that will segregate lands, the parties are well advised to identify any extraordinary "residual" contractual interests, rights, liabilities or obligations that exist which may not necessarily transfer to the assignee party with the assignment of a specific interest in lands under a NOA and then determine what should or can be assigned and what other type of agreement or transfer document may be needed, other than the NOA, to effec8t the transfer and assignment of such extraordinary matters.

e) Something like the following sentence should be added to the covering consent letter for a NOA when sent out: **"The enclosed Notice of Assignment is being served to only those Third Parties to the Master Agreement that hold an interest in common with the Assignor with regard to all or a portion of the "Assigned Interest" in accordance with the *Segregation Protocol [Version: CAPLA 2011]*."**

**Illustration of Procedure for serving a NOA based on the Segregation Protocol**

Working interest percentages (WI%) held by the parties in the various Segregated Blocks at the time of the assignment for each of the following scenarios:

| Segregated Block #1 | Segregated Block #2 | Segregated Block #3 |
|---|---|---|
| Party A – 30% | Party A – 25% | Party B – 25% |
| Party C – 30% | Party C – 50% | Party E – 25% |
| Party D – 20% | Party E – 25% | Party F – 50% |
| Party E – 20% | | |

Scenario 1 - Party A is selling its entire WI% in Block #1 only to Party X –
Option B would be selected and the assigned interests described as, "Assignor's entire interest in the Block #1 Lands". Party C, D & E are listed as Current Third Parties.

Scenario 2 - Party E is selling its entire WI% in Block #1 and Block #2 only to Party Y –
Option B would be selected and the assigned interests described as, "Assignor's entire interest in the Block #1 and Block #2 Lands". Party A, C & D are listed as Current Third Parties.
(Note: see subclause b) of the Procedure for Serving Notices regarding why it is not recommended to select Option A in this case, even though it would appear Party E is assigning all of the the interests it holds in common only with Parties A, C & D)

Scenario 3 - Party A is selling its entire WI% in both Block #1 and Block #2 to Party X –
Option A would be selected for the assigned interests. Parties C, D & E are listed as Current Third Parties.
(Note: this scenario differs from Scenario 2 above in that Party A will not be retaining an interest in any other Segregated Blocks under this agreement after the assignment)

Scenario 4 - Party C is selling only 50% of its WI% in both Block #1 and Block #2 to Party Y –
Option B would be selected and the assigned interests described as, "50% of Assignor's 30% working interest (being a net undivided 15% WI) in the Block #1 Lands and 50% of Assignor's 50% working interest (being a net undivided 25% WI) in the Block #2 Lands ". Party A, D & E are listed as Current Third Parties.

Scenario 5 - Party E is selling its entire WI% in all three blocks of lands to Party Z –
Option A would be selected for the assigned interests. Parties A, B, C, D & F are listed as Current Third Parties.

## SECTION IV – THE SEGREGATION PROTOCOL

[Version: CAPLA 2011]

Notwithstanding anything to the contrary contained in an agreement, including its schedules, or otherwise in contravention of any contract or common law:

1. When any portion of the lands or any other asset (including, but not limited to a production facility or wellbore) governed under an agreement ceases to be owned between the same parties or in the same percentages of interest, each such portion of land or any such asset shall be called a "Segregated Block". For purposes of Clause 2, all those portions of the lands and assets governed under an agreement that continue to be held by all the same parties in the same interests will be considered as one Segregated Block.

2. When any notice of assignment ("NOA") is required to be served under an agreement with respect to the assignment of a party's interest in a Segregated Block, such NOA shall name, as the Current Third Party to Master Agreement, and be served only to those parties having an interest in that Segregated Block to which the NOA pertains.

3. Notwithstanding Clause 2, if a party is disposing of its interests in more than one Segregated Block under an agreement, it may serve a single NOA to all of those third parties holding an interest in any of those Segregated Blocks for the disposition of its interests under all of those Segregated Blocks if: (i) it is disposing of an interest under all of such separate Segregated Blocks that, when combined, cover all of its interests under that agreement; or (ii) that party identifies clearly in the NOA each Segregated Block to which the NOA pertains and the interest being assigned in each such block.

4. A party shall have no cause to reject any NOA served in accordance with Clause 2 and 3 if, in all other respects, it has been served in accordance with and in the form required by the provisions of the agreement or its schedules, as is applicable; and, any such NOA shall have full effect under the agreement as if otherwise served to all parties to the agreement.

5. Except to the extent of the foregoing modification to the naming and the service of a NOA to the parties, the CAPL 1993 Assignment Procedure, including a party's right to reject a NOA for any other reason allowed for therein and not contemplated by this Segregation Protocol, remains in full force and effect and the terms and conditions thereof are to be complied with in all other respects and the form of the NOA attached as Appendix "A" thereto is not to be otherwise modified by any party serving a NOA.

## SECTION V – AGREEMENT TEMPLATES

### Segregation Protocol Clause - New Agreements

If the parties, when entering into a new agreement, wish to have the Segregation Protocol more formally adopted, the complete wording of the Segregation Protocol [Version: CAPLA 2011] could be expressly set out in the agreement or the following clause could be added to the agreement:

*"The parties agree that the Segregation Protocol [Version: CAPLA 2011], is hereby adopted by this reference and shall be accepted and followed by all the parties for purposes of serving any notice of assignment hereunder."*

### Segregation Protocol Addendum - Old Agreements

If the parties to an existing agreement wish to have the Segregation Protocol more formally adopted, the following form of letter agreement could be used (e.g. this letter could be sent out with the consent letter for the next NOA to be served under that agreement and thereby efficiently and effectively addressing segregation as and when it occurs under your old agreements).

*(Note: this addendum is not intended for clarification or ratification of the parties' interests under an agreement. If the agreement is in such a state that clarification or ratification is required, it is strongly recommended that new operating agreement(s) be entered into among the current parties holding interests in the lands incorporating the Segregation Protocol Clause above).*

*.....*
*Date*

*Addressees*

*RE: Addendum to Agreement for Adoption of Segregation Protocol*

*This addendum is to that _____ Agreement dated _____, originally between or among _____ (the "Agreement").*

*Whereas _____ list all current parties to the Agreement _____ are the current parties to the Agreement (the "Parties"), and the Parties wish to amend the Agreement for adoption of the Segregation Protocol [Version: CAPLA 2011] (the "Segregation Protocol").*

*Therefore, the Parties hereby agree that the Segregation Protocol is to hereby adopted by this reference and shall be accepted and followed by the Parties for purposes of serving any notice of assignment under the Agreement from and after the date hereof.*

*The Parties acknowledge and agree that, in accordance with the Segregation Protocol, as of the date hereof, the Segregated Blocks under the Agreement (each Segregated Block being any interests under the Agreement that are held in the same percentage interests by the same Parties, as further defined by the Segregation Protocol), the Parties' interests in those Segregated Blocks and the respective designated Operator for each Segregated Block, are as set out in Schedule "A" attached hereto.*

*Yours truly,*

*Accepted and agreed to this _____ day of _____, 20___,*

*CURRENT PARTY(IES) TO AGREEMENT*

*Per: _____*

***EXAMPLE***

*SCHEDULE "A"*
*attached to and forming part of that*
*Addendum to Agreement for Adoption of Segregation Protocol dated _____*
*that _____ Agreement dated _____, originally between or among*
*_____*

**SEGREGATED BLOCK 1**

Designated Operator of Segregated Block 1: ABC Company

| *Lands* | *P&NG Rights* | *Current Third Party Name* | *Third Party Interest* |
|---|---|---|---|
| Twp 1 Rge 1 W1M: Sec 1, 2, 3, 4, S&NE 5 | PNG surface to base Belly River | ABC Company<br>XYZ Limited<br>Royalty Co. | 50%<br>50%<br>5% non-convertible GOR on 100% prod of oil and gas |

**SEGREGATED BLOCK 2**

Designated Operator of Segregated Block 2: XYZ Limited

| *Lands* | *P&NG Rights* | *Current Third Party Name* | *Third Party Interest* |
|---|---|---|---|
| Twp 1 Rge 1 W1M: Sec 1, 2, 3, 4, S&NE 5 | PNG from below base Belly River to basement | XYZ Limited<br>Royalty Co. | 50%<br>50% |

**SEGREGATED BLOCK 3**

Designated Operator of Segregated Block 3: ABC Company

| *Lands* | *P&NG Rights* | *Current Third Party Name* | *Third Party Interest* |
|---|---|---|---|
| Twp 1 Rge 1 W1M: Sec 6, 7, 8 | PNG surface to base Mannville | ABC Company<br>XYZ Limited | 75%<br>25% |

**ETC.**