THE 1981 CAPL OPERATING PROCEDURE

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*The author outlines the substantive changes that have been made by the Canadian Association of Petroleum Landmen in its 1981 Operating Procedure. The philosophy behind the changes is outlined and guidance is provided for the interpretation of the effect of the provisions. As well, possible difficulties in interpretation and limitations on the effectiveness of certain provisions are examined.***

INTRODUCTION

Since 1969, the Canadian Association of Petroleum Landmen ("CAPL" or the "Association"), successor to the Alberta Association of Petroleum Landmen, has developed four standard forms of Operating Procedure that oil and gas operators could use in joint interest operations, the 1981 version being the most recent. The CAPL Operating Procedure is designed to be a supplemental document to an introductory agreement among the parties. The introductory agreement must, as a minimum, describe the "joint lands", state the respective "participating interests" of the parties, and designate the "Operator". The introductory agreement may also contain special provisions concerning drilling obligations and drilling options, overriding royalties, conversion of overriding royalties, and areas of mutual interest. Although the introductory agreement may delay the operative effect of the CAPL Operating Procedure until the completion of an earning phase as in a Farmin or Farmout Agreement, or until the completion of a drilling obligation as in a Joint Operating Agreement, the CAPL Operating Procedure will eventually govern the ongoing, day-to-day joint interest operations of the parties.

Although the CAPL Operating Procedure deals with many other activities, it particularly concerns the drilling, completing, equipping and operating of joint interest wells. The CAPL Operating Procedure delimits these four categories of operations as follows:

(a) drilling encompasses everything up to casing point and if the well is unproductive, includes abandonment;

(b) completing commences at casing point and carries the operation through to and including production testing, and explicitly includes treating and "fracing";

(c) equipping commences after production testing and primarily deals with the installation of salvable material, but specifically stops at the entry point into a gathering system, plant or other common facility which will be governed by a separate facilities agreement;

(d) operating concerns the subsequent operations of the well.

It is the purpose of this paper to review and comment on the substantive changes that the Association has made in its 1981 Operating Pro-

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cedure (the "1981 CAPL" or the "CAPL Operating Procedure"). The articles and clauses of the 1981 CAPL will be reviewed in sequence.

ARTICLE I – DEFINITIONS, HEADINGS AND REFERENCES

The Association places considerable importance on this Article and hopes that the words and phrases defined in it will be used consistently in all associated documentation.

A. *Clause 101(d) — "casing point"*

This is a new definition in the 1981 CAPL which reinforces the distinction between the categories of drilling and completing. It has particular application in the definition of "completion costs" in subclause (f) of Clause 101 and in Article IX – Casing Point Election. An Authority for Expenditure (AFE) relates only to the drilling of a well to total depth and not to the completing of it, which may be subject to penalties.

B. *Clause 101(e) — "commercial quantities" and*
Clause 101(p) — "paying quantities"

Clause 101(e) is a new definition in the 1981 CAPL and should be contrasted with the definition of "paying quantities" in subclause (p).

"Commercial quantities" indicate that the anticipated output of petroleum substances from a well that has been drilled economically warrant the drilling of another well in the same area to the formation or formations which the first well has shown to be productive.

"Paying quantities" indicate:

1. that the anticipated output of petroleum substances from a well that has been drilled but not completed and equipped, economically warrant incurring the completion costs and the equipping costs of that well; or

2. that the anticipated output of petroleum substances from a well that has been drilled, completed and equipped, economically warrant producing the petroleum substances from that well.

The inherent weakness of these definitions is that they depend upon the interpretation or construction to be given to the words "would economically warrant". What criteria are the Joint-Operators, let alone the courts, to use to define this expression? With such legislative innovations as the Canadian Ownership Rate and the Petroleum Incentives Program, anticipated production may economically warrant one Joint-Operator incurring completion and equipping costs but may not economically warrant another Joint-Operator incurring those costs.

It should also be realized that, although defined, the phrase "commercial quantities" is not used in the 1981 CAPL. One cannot help but wonder why the definition was included at all.

C. *Clause 101(h) — "equipping costs"*

The 1981 CAPL has expanded this definition to identify in greater detail the equipment to be provided in equipping a well for the taking of production and the point in time at which equipping ceases, namely, at the entry point into a gathering system, plant or other common facility. As entry points may vary from well to well depending upon the type of common facility used, problems may develop in determining equipping costs.

ARTICLE II – APPOINTMENT AND REPLACEMENT OF OPERATOR

A. *Clause 203 — Challenge of Operator*

The most significant change to this provision is its overriding effect on Clause 206 — Appointment of New Operator. Under both the 1974 CAPL and the 1981 CAPL, Clause 206 governs the appointment of a challenging Joint-Operator to the position of Operator. Clause 206 requires the new Operator to be appointed by the affirmative vote of two or more parties representing a majority of the participating interests, failing which the party having the greatest participating interest is to act as Operator "pro tem". The 1981 CAPL provides that if no other Joint-Operator is prepared to act as Operator on the terms and conditions set out in the challenge notice, then the Joint-Operator giving the challenge notice becomes the new Operator. Under the 1974 CAPL, if the challenging Joint-Operator did not receive the requisite votes, even though no other Joint-Operator was prepared to act, the party having the greatest participating interest assumed operatorship.

Clause 203 is expressed in sufficiently broad language to cover a challenge based upon operational or financial improvement. However, as W.G. Brown has pointed out, both types of challenge have disadvantages in their application:[1]

> In the case of a challenge upon the basis of operational improvement, excepting the most obvious cases, how does the challenger show that his proposal is an improvement, and what is to prevent him from making a proposal that is, in fact, not an improvement at all? Is the operator to be forced into a position of meeting terms that are really not as desirable for the joint operation as those under which he is presently conducting his operations? In the case of a challenge on the basis of financial improvement, the obvious argument is that any operation can be conducted at less cost if it is not done as well.
>
> In addition to these disadvantages to the operation generally, there are drawbacks from the challenger's point of view. It seems likely that when the challenge is made, whether it be based upon a complaint of operational procedures or financial improvement, there would be questions raised as to whether the challenge was warranted, whether the proposal made is, in fact, an improvement and other rather pointless debate.

W.G. Brown suggests the provision for pre-emptory challenge as a resolution to this problem, provided that the challenger operate on no less favourable terms than those currently governing the operation.[2]

Another change in Clase 203 is that the failure of the Operator to advise the Joint-Operators of its decision concerning the challenge notice within the requisite time period is deemed to be an election by the Operator to resign. The 1974 CAPL had not addressed this issue.

Clause 203 should be juxtaposed with Clause 205 which enables the Operator, after two years, to request modification to the terms and conditions of its operatorship. The premise on which operatorship is predicated in the CAPL Operating Procedure is that an Operator is not expected to make or lose money on operations but rather simply be kept whole for its efforts.

ARTICLE III – FUNCTIONS AND DUTIES OF OPERATOR

A. *Clause 301 — Control and Management of Operations*

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1. W.G. Brown, "Independent Operations, Obligatory Operations and Challenge of Operator Provisions in Joint Venture Agreements" (1970) 8 *Alta. Law Rev.* 216 at 221.
2. *Id.*

The 1981 CAPL has made what, at first glance, would appear to be a significant change in the philosophy of operatorship and in the relationship between the Operator and the other Joint-Operators. The Operator is no longer delegated the "exclusive" control and management of the exploration, development and operation of the joint lands for the joint account. Rather, the Operator is now delegated control and management provided it "consult with the Joint-Operators from time to time with respect to decisions to be made for the exploration, development and operation of the joint lands, and keep the Joint-Operators informed with respect to operations planned or conducted for the joint account". This appears to apply even if the decisions and operations are within the Operator's written AFE. The Operator is, however, entitled to make or commit to such operating expenditures for the joint account as it considers "necessary and prudent in order to carry on a good and workmanlike operation for the joint account", provided it not make or commit to an expenditure for any single operation in excess of $25,000 ($10,000 in the 1974 CAPL) without a written AFE from the Joint-Operators.

The fiduciary nature and scope of the relationship between the Operator and the other Joint-Operators under a joint operating agreement has been thoroughly examined by others in a number of articles.[3] Briefly, the position may be summed up as follows: "Canadian courts will recognize various types of fiduciary relationships with varying degrees of responsibility, such responsibilities not being confined necessarily to the "four corners" of the agreement itself . . . " despite the expressed intent of the parties either to deny completely the fiduciary relationship or to confine the relationship to the terms of the agreement through such provisions as Clause 303 — Independent Status of Operator (Operator is an independent contractor), Clause 1501 — Parties Tenants in Common, and Clause 2701 — Supersedes Previous Agreements.[4]

Nevertheless, the change in philosophy in the 1981 CAPL appears to be an attempt to place the role of the Operator in perspective suggesting that it is incidental to a party's role as a joint interest owner. The CAPL Operating Procedure should be open enough to enable the Operator to carry out prudent control and management of the joint lands. As R.C. Muir has stated:[5]

> Generally speaking, under the usual form of operating agreement, the position of the operator is not like that of the old Scottish overseer managing vast tracts of Irish lands for absentee owners who have not inspected the lands in three generations. Under operating agreements such freedom as is consistent with the existence of co-ownership should prevail so as to allow each party to pursue his own interest regarding the lands subject to the agreement and adjoining thereto. The

3. *See* E.M. Bredin, "Types of Relationship Arising in Oil and Gas Agreements" (1963-64) 3 *Alta. Law Rev.* 333; J.B. Ballem, "The Scope of the Fiduciary Relationship" (1963-64) 3 *Alta. Law Rev.* 349; R.C. Muir, "Duties Arising Outside of the Fiduciary Relationship" (1963-64) 3 *Alta. Law Rev.* 359; G.M. Burden, "The Operating Agreement for the Development of Petroleum and Natural Gas Resources" (1965) 30 *Sask. Bar Rev.* 325; G.R. Pellatt, "The Fiduciary Duty in Oil and Gas Joint Operating Agreements — Midcon Re-examined" (1968) 3 *U.B.C. Law Rev.* 190; D.A. MacWilliam, "Fiduciary Relationships in Oil and Gas Joint Ventures" (1970) 8 *Alta. Law Rev.* 233; R.H. Bartlett, "Rights and Remedies of an Operator vis-a-vis a Defaulting Non-Operator under Joint and Unit Operating Agreements" (1972) 10 *Alta. Law Rev.* 288.

4. J.B. Ballem, "The Scope of The Fiduciary Relationship" (1963-64) 3 *Alta. Law Rev.* 349 at 351, 352 and 354.

5. R.C. Muir, "Duties Arising Outside of the Fiduciary Relationship" (1963-64) 3 *Alta. Law Rev.* 359 at 365.

operator is merely one of the owners who, for the time being, and subject to the express provisions of the agreement as to supplying information, etc., carries on the routine tasks of hiring contractors to drill wells, lay flow lines and store production. Discussion as to exploitation takes place between the parties, subject to voting provisions, as equal co-owners.

It is unclear, however, what is contemplated by the duty of the Operator to "consult with" the Joint-Operators as set out in Clause 301. Is it simply to inform, or to take the other Joint-Operators' suggestions under advisement, or to obtain the concurrence of the other Joint-Operators before acting? The cardinal principle governing the interpretation of contracts is that each word in the contract must be given its plain or ordinary meaning. The ambiguous nature of the phrase "consult with" will do nothing to aid the courts in determining the Operator's duty under Clause 301.

Furthermore, Clause 301 provides no remedy for the Joint-Operators if the Operator should fail to consult with them. Is it expected that the Joint-Operators will issue a "challenge notice" pursuant to Clause 203 to force the Operator to perform his duty, or will seek to replace the Operator pursuant to subclause 202(6)(ii)? Neither provision seems appropriate to remedy the situation.

The Operator is also without remedies under the supplementary AFE. The 1981 CAPL has added a new provision concerning the written supplementary AFE. If the Operator, while conducting any single operation for the joint account pursuant to a written AFE, incurs or expects to incur expenditures for the joint account in excess of the AFE amount plus 10%, the Operator is required to advise the Joint-Operators forthwith and to submit for their approval a supplementary AFE for the excess expenditures. The provision, however, is silent as to the consequences if a Joint-Operator should fail to approve the supplementary AFE. The parties must, therefore, specifically provide for a remedy to cover this eventuality. Quaere, whether they would wish to go so far as to deem the activity covered by the supplementary AFE to be an "independent operation" resulting in the imposition of a penalty upon the non-approving Joint-Operator should it fail to participate in the supplemental costs. R.H. Bartlett has stated that, generally, the remedies available to the Operator under the law of contract, apart from the operating agreement, are inappropriate to his needs.[6] It is doubtful that an even less than adequate remedy would be available to the Operator under the law of contract to deal with this situation in the absence of a specific remedy under the CAPL Operating Procedure.

B. *Clause 311 — Insurance*

The most significant change made in this Clause by the 1981 CAPL is the provision in Alternate - B enabling the Joint-Operators to be self-insurers to the extent that governmental regulation allows the Operator to pass this responsibility on to the owners of interests in the joint lands.

Subclause (c) of Alternate - B provides that the individual parties will bear third party liability arising out of joint operations in proportion to their respective participating interests. Since third party liability insurance generally excludes the contractual assumption of liability by the insured, Joint-Operators should obtain a contractual assumption of

6. R.H. Bartlett, "Rights and Remedies of an Operator vis-a-vis a Defaulting Non-Operator under Joint and Unit Operating Agreements" (1972) 10 *Alta. Law Rev.* 288 at 293.

liability rider in their insurance policies. That rider should also cover their own negligence. Two recent cases of the Alberta Court of Queen's Bench are worth noting in this regard.

The first case, *Bow Helicopters Ltd.* v. *Bell Helicopter Textron and Avco Lycoming Engine Group, Stratford Division*[7], decided on April 25th, 1980, involved the lease of a helicopter. The lease required the lessee, Bow Helicopters, to provide insurance and a certificate of insurance protecting the lessor's (Bell Helicopter's) interest in the helicopter, which it did. The helicopter was damaged by a cause insured against and the lessee's insurer attempted to exercise its right of subrogation against the lessor. The lessor claimed that it was an insured and that no right of subrogation existed. Moshansky, J., held that the lessee's insurers were bound by the contractual relationship between the lessee and the lessor and specifically by the contractual undertaking by the lessee to obtain a waiver of subrogation as to the lessor. Furthermore, the lessor was in fact indemnified by the lessee's insurers, and the loss suffered was the lessor's, not the lessee's. Citing an American case, *Alleghany Air Lines Inc.* v. *Gen. Motors Corpn.*[8], Moshansky, J. held that the test was the true relationship of the parties and that an insurer cannot subrogate against its own insured. No reference is made in the judgment to the particular terms of the insurance policy.

The second case, *City of Edmonton* v. *Eagle Star Insurance Company Limited and British Northwestern Insurance Company*[9], decided fewer than 3 weeks after the *Bow Helicopters* case, involved the construction of an addition to a power station owned by the City of Edmonton. As a result of the contractor's negligence, the power station suffered damage, and the City of Edmonton sought to recover damages from the contractor's insurers when it was found that the contractor had become insolvent. The building contract obligated the contractor to continuously maintain " . . . adequate protection of all his work from damage and . . . protect the Owner's property from all injury arising in connection with this Contract . . . "[10], and to " . . . make good any such damage or injury, except such as may be directly due to error in the Contract Documents."[11] The Contractor's insurance policy contained a provision excluding liability assumed by the insured under agreement with another. The City of Edmonton claimed that this exclusion applied only to liability under contract and not to liability in tort for negligence. Legg, J., citing *Dom. Bridge Co.* v. *Toronto Gen. Ins. Co.*[12], held that the construction to be placed upon a policy in cases such as the one at bar was:

(1) is there a "liability imposed by law" within the coverage (and in this regard no distinction is to be made between "liability imposed by law" and "liability assumed under contract"),

(2) is that liability also assumed under contract within the exclusion clause,

(3) if so, the liability is excluded from the coverage.

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7. (1980) 12 Alta. L.R. (2d) 362 (Q.B.).
8. (1960) II Aviation Cases 17391 (N.Y.S.C.).
9. (1980) 13 Alta. L.R. (2d) 27 (Q.B.).
10. *Id.* at 30.
11. *Id.*
12. (1961) 34 W.W.R. 289 (B.C.S.C.); *affd.* 45 W.W.R. 125 (S.C.C.).

Because of the absence of any reference to the insurance policy in the *Bow Helicopters* case, one cannot categorically state that *Bow Helicopters* supports the proposition that in the absence of an exclusion clause in an insurance policy, insurers are bound by the contractual assumption of liability by their insured. One can state, however, on the basis of the *City of Edmonton* case, that if the assumption of liability is excluded by the insurance policy, the exclusion clause will prevail.

As a result of the Supreme Court of Canada decision in the *Greenwood* case (*infra*), Joint-Operators should include the words, "... its employees, servants and agents" in subclause (d) of Alternate-B. *Greenwood Shopping Plaza Ltd.* v. *Beattie et al*[13] considered the waiver by a lessor in a shopping centre lease of its subrogation rights for recovery of loss caused by the acts of the lessee. The Court held that the lessor, although precluded from asserting a claim against the lessee, was not precluded from suing the lessee's individual employees whose negligence had caused the loss. The concept of privity establishes that a person not a party to a contract can neither sue to enforce it nor rely upon it to protect himself from liability, except in cases of agency or trust which must be supported by persuasive evidence.

Alternate - A of Clause 311 has been revised to reflect higher damage limits in all categories, to limit the deductible in any insurance, and to provide for a waiver of subrogation in favour of the Joint-Operators. Subclause (d) of Alternate-A should, like subclause (d) of Alternate-B, also include the words, "... its employees, servants and agents."

C. *Clause 312 — Taxes*

This provision has been revised to specifically exclude various taxes such as mineral and conservation taxes as well as assessments or levies based on reserves, a unit of production or the value thereof.

ARTICLE IV — INDEMNITY OF OPERATOR

A. *Clause 401 — Limit of Liability*

This provision has been revised to hold the Operator solely liable for such losses as the Joint-Operators may incur by reason of the Operator's failure to carry the insurance required under Clause 311. The losses, however, are limited to the extent of the insurance the Operator was required to carry. Joint-Operators should realize that Clause 401 only requires the Operator to indemnify the Joint-Operators against claims brought by third parties and does not apply to direct loss to the Joint-Operators caused by the operations.[14] Furthermore, Clause 401 will apply to an alleged breach of fiduciary duty by the Operator.[15]

The type of indemnity provision contained in Clause 401 is what P.G. Schmidt has called a "primary" indemnity clause.[16] In addition to these provisions, the CAPL Operating Procedure contains what P.G. Schmidt has also described as "secondary" indemnity clauses. These relate to liability arising from independent operations such as re-entry to or abandonment of a well, as well as to surrender of the agreement or to further

13. (1980) 111 D.L.R. (3d) 257 (S.C.C.).
14. *Mobil Oil Canada Ltd.* v. *Beta Well Service Ltd.* (1974) 43 D.L.R.(3d) 745 (Alta. S.C.A.D.).
15. *Act Oils Ltd.* v. *Pacific Petroleums Ltd.* (1975) 60 D.L.R.(3d) 658 (Alta. S.C.A.D.).
16. P.G. Schmidt, "Vicarious Liability in Tort" (1966-67) 5 *Alta. Law Rev.* 74, at 107.

assignment of the rights thereof[17], such as Clause 1017. The CAPL Operating Procedure also contains certain devices to avert "indirect" liability. One device is to attempt to limit the liabilities of the parties, as in Clause 311, Alternate - B, subclause (c). Another device is to define the exact relationship between the parties, as in Clause 1501. R.H. Bartlett has pointed out that the utility of such provisions is limited as they cannot prevent the parties from attracting joint liability if in fact they conduct themselves as a partnership or joint venture.[18] To support this view he cites the case of *Canadian Delhi Oil Ltd.* v. *Alminex Limited et al*[19], where Smith, C.J.A. in the Appellate Division of the Supreme Court of Alberta, held that a clause negativing both a partnership and association could not avert the attachment of joint liability in the conduct of unit operations. Smith, C.J.A. at page 531 cited the following statement of Viscount Cave, L.C. in *Ross* v. *Can. Bank of Commerce*[20] (an appeal from the Ontario Supreme Court, Appeal Division, which affirmed, without reasons, the judgment of Rose, J. of the High Court Division of the Supreme Court), as being applicable:

> It appears to their Lordships to be immaterial whether the combination is called a partnership or a joint adventure. Probably it was a partnership. But, in any case, it was a combination, and it was part of the terms on which the combination was made that a business should be carried on and liabilities should be incurred; and if in the course of carrying on that business liabilities were incurred, either by the combination or the partnership or the syndicate (whichever it is called) or by a member on its behalf, within the limits of the adventure, then those liabilities bound both members of the syndicate and not only the one by whom the liability was actually incurred.

ARTICLE V — COSTS AND EXPENSES

A. *Clause 503 — Advance of Costs and Expenses*

The 1981 CAPL has added an element of reciprocity to this provision so that any advances by a Joint-Operator that are not then required by the Operator for charges to the joint account are to be refunded to that Joint-Operator in a prompt and timely manner. If they are not refunded by the end of the next calendar month, the Joint-Operator may charge the Operator interest at prime plus 2% on the amount not refunded until it has been paid.

This Clause may be appropriate for the standard type of drilling operation where relatively small sums of money are being advanced. But in operations where larger sums are required, such as the frontier, the Joint-Operators might consider the method which was used for Syncrude. (In fact, given the current high interest rates, the Joint-Operators might do well to consider it for standard operations.) In Syncrude a zero accounting concept was used. All Joint-Operators, including the Operator, opened and maintained various current accounts at one bank. The bank was authorized at the close of every banking business day to debit from each Joint-Operator's account, in proportion to the Joint-Operator's participating interest, any debit balances in the Syncrude General Account created by the Operator, so that at the end of each day the Syncrude General Account had a zero balance.

17. *Id.*
18. *Supra n. 6* at 289.
19. (1967) 62 W.W.R. 513 (Alta. S.C.A.D.); *affd.* [1968] S.C.R. 775.
20. [1923] 3 D.L.R. 339 at 342 (J.C.P.C.); *affg.* 51 O.L.R. 42 (H.Ct.).

ARTICLE VI — OWNERSHIP AND DISPOSITION OF PRODUCTION

A. *Clause 605 — Distribution of Proceeds*

This is a new provision dealing with the distribution of proceeds received by one party from the sale of another party's share of production. The proceeds are to be distributed within 10 days, failing which the undistributed amount may bear interest at prime plus 2% until paid. There is nothing in this provision, however, enabling the Operator to set off proceeds against money otherwise owning.

ARTICLE VII — OPERATOR'S DUTIES RE DRILLING AND COMPLETING WELLS FOR JOINT ACCOUNT

A. *Clause 701 — Pre-Commencement Information*

The 1981 CAPL requires the AFE to include more detailed information such as the location and intended total depth of the well, the Operator's proposed completion program and the expected time of commencement of the well. If the AFE does not contain the expected time of commencement, a Joint-Operator may approve the AFE on the condition that the well be commenced within a specified time (and, if approved by all other Joint-Operators, the condition will prevail), or, subsequent to approving the AFE without that condition, may give notice to the other Joint-Operators requiring that the well be commenced within 60 days of its notice, failing which the Joint-Operator's previous approval of the AFE will be void.

The 1981 CAPL also provides that a well is deemed to be commenced when actually spudded, that is, when an adequate drill rig is set up on location and a drilling bit has penetrated the surface.

B. *Clause 702 — Drilling Information and Privileges of Joint-Operators*

The 1981 CAPL has added a provision to this Clause enabling a Joint-Operator to obtain, upon request, estimates of current and cumulative costs incurred for the joint account. This provision does not, however, lessen the obligation of the Operator under Clause 301 to submit to the Joint-Operators a supplement AFE if costs exceed the then approved amount by 10%.

C. *Clause 704 — Completion and Production Information to Joint-Operators*

This is a new provision which expands Article VII to require the flow of information through completion and production testing. The Operator is required to provide the Joint-Operators with reports concerning casing programs, perforations, formation treatment and stimulation, back pressure tests, and, upon request, estimates of current and cumulative costs, including all relevant information concerning formation and production tests, and the nature, rate and amount of petroleum substances and other fluids produced from the well.

D. *Clause 705 — Additional Testing by fewer than all Joint-Operators*

Although this provision had been included in the 1974 CAPL under Article VIII, VELOCITY SURVEYS, ETC., it was considered to belong more logically in Article VII notwithstanding its similarity to Clause 801. This provision enables one Joint-Operator to conduct, independently, additional tests on a joint well for its own account and for its own informa-

tion, unless the Operator advises the Joint-Operator that the hole is not in satisfactory condition. This provision should not be confused with an "independent operation" proposed under Article X; in Clause 705 no decision has been made to abandon the well or to cease operations thereon.

ARTICLE VIII — VELOCITY SURVEYS AND OTHER GEOPHYSICAL TESTS

A. *Clause 801 — Velocity Surveys and Other Geophysical Tests*

The 1981 CAPL has revised this Clause so that a copy of the velocity survey may be obtained for the greater of 1/6th of its cost or the participating interest of the party wanting it. In the 1974 CAPL the cost was 1/8th of the cost of the survey. It should be noted that tests other than velocity surveys do not have to be offered to any Joint-Operator.

ARTICLE IX — CASING POINT ELECTION

A. *Clause 901 — Agreement to Drill Not Authority to Complete*

The 1981 CAPL has included an assurance in this Clause that agreement to drill or deepen a well does not include agreement to the completion program set forth in the AFE issued under Clause 701. This revision enables the parties to include estimated completion costs in the AFE without approval of that AFE being construed as an agreement to participate in the completion attempt. That decision is left to "casing point" except, of course, if the AFE was entirely predicated on conducting certain operations contained in the definition of completion, such as "fracing", in which case this should be explicitly provided in the AFE.

B. *Clause 902 — Election by Joint-Operators re Casing and Completion*

Failure to reply to the Operator's notice concerning the setting of production casing and a completion attempt is deemed to be an election to complete provided at least one other Joint-Operator, other than a Joint-Operator that failed to reply, has also elected to participate therein. Furthermore, no party can be required to participate beyond its participating interest.

C. *Clause 903 — Fewer Than All Parties Participate*

The 1981 CAPL has added the following provisions to Alternate-B:

1. If a well is abandoned within six months of the completion attempt, any income received by the participants from the sale of production within the six months or from the sale of salvable material and equipment is applied firstly to abate costs incurred by the participants in the completion attempt, and the balance is credited to the joint account.

2. If and when a well is abandoned as a producer, the interests assigned to the participating parties are, upon such abandonment, re-assigned to the original assignors and included in the joint lands.

ARTICLE X — INDEPENDENT OPERATIONS

A. *Clause 1002 — Proposal of Independent Operation*

Consistent with revisions in Clause 701 concerning the content of the AFE, the 1981 CAPL requires that an operation notice under Clause 1002 shall be sufficiently detailed stating the nature of the operation, the proposed location, the expected time of commencement, the purpose and estimated cost of the operation, and stating whether it is a development

well or an exploratory well, or both. The estimate of expenditures may be in the form of an AFE, provided an AFE submitted pursuant to any other clause of the Operating Procedure shall not in itself be construed as an operation notice unless it is specifically part of an operation notice served pursuant to Article X.

An operation notice may relate to no more than one well. However, multiple operation notices may be served provided that the party serving them states the order in which the operation notices are to be deemed to be received by the receiving parties. In the case (and only in the case) of a drilling operation, the receiving parties are not required to operate as having received the operation notice until all previously served operation notices by that other party relative to wells located within 3 miles of the proposed well have expired or have been withdrawn, or until the operation has been completed, the information therefrom having been provided and the receiving parties so advised.

B. *Clause 1005 — Separate Election Where Well Status Divided*

Subclause (b) of this provision has been completely rewritten. Where participation in a well varies between a development and an exploratory well, the following will occur:

1. the drilling costs and completion costs will be allocated between the development and exploratory well and the allocation will be set out in the operation notice;

2. where a well is capable of producing petroleum substances in at least paying quantities from more than one geological formation and the petroleum substances can be produced simultaneously from all those formations, the Operator for the participating parties in the deepest producing formation shall operate the well and apportion the operating costs of the well to each producing formation on an equitable basis, and shall deliver to the Operator for the participating parties in each productive formation their respective total share of production from each formation;

3. notwithstanding item 2, where the well is capable of producing petroleum substances in at least paying quantities from both a geological formation that is contained in the exploratory part of the well and one that is contained in the development part of the well, the participating parties in the designated exploratory well shall have the pre-emptive right to complete the well in the deep zone, provided that the participating parties in the development designated well are reimbursed for all costs incurred by them in drilling (and completing, if applicable) the well as a development well, and thereafter the well will be deemed to be a single operation for the account of the participating parties in the exploratory well.

C. *Clause 1007 — Penalty Where Independent Well Results in Production*

The 1981 CAPL specifies more clearly that the penalty percentage only applies to the drilling and completion costs but that the participating parties are entitled to recover:

(a) the costs attributable to payment of royalties and to operations; and

(b) the costs of equipping the well including interest on the unrecovered amount thereof.

Furthermore, the Operator is required to advise the non-participating parties when the penalty has been recovered. The non-participating party then has 30 days in which to elect to accept or refuse participation in the formation and the production from the well. If the non-participating party accepts participation, its participation will be equal to its participating interest. The accounts will be adjusted accordingly and the well will be held for the account of the parties then participating. If the non-participating party refuses participation, it forfeits its right of participation. Silence by the non-participating party will constitute an election to refuse participation, an election which may result in the non-participating party sharing the costs of abandonment.

Subclause (d) makes it clear that cash contributions from non-governmental sources are a deduction from the cost base on which the penalty is calculated. Subclause (e) makes it equally clear that any government cash payments, incentives, grants (e.g., P.I.P. grants), credits, waivers, exemptions, abatements or other benefits received by or available to the participants will not be taken into account for the purposes of calculating payout.

Joint-Operators should realize that Clause 1007 does not purport to deal with the issue of liability, during the penalty period, for independent royalties which have been created by a non-participating party. It is not stated that the royalty obligations are assumed by the participating parties with respect to penalty production foregone by the non-participants. Nor does the 1981 CAPL provide for the inclusion of royalties in the calculation of the penalty other than those otherwise borne by the joint account.

D. *Clause 1008 — Independent Deepening, Plugging Back, Whipstocking, Re-Completing, Reworking or Equipping*

Subclause (e) is a new provision. If within six months of receipt of the operation notice the participating parties elect to terminate the operation or propose to abandon the well, they shall so notify the non-participating parties and shall thereby be deemed to have returned the well and the formations to the non-participating parties. All further operations, including abandonment, will be for the joint account except that the salvable materials and equipment placed by the participating parties will be salvaged by and for the account of the participating parties and the participating parties will bear all extra costs of abandonment by reason of the operation.

In the event that the participating parties do not propose termination of the operation or abandonment of the well within the six month period, the non-participating parties shall be paid their share of any salvage value.

E. *Clause 1010 — Exception to Clause 1007 Where Well Preserves Title*

The critical period for the drilling of a well to preserve title has been changed from 45 days to the final 1/6th or the final 365 days of the term of the title document which is due to terminate, whichever is the shorter period. This change should adequately handle lease-earning wells on which there is a Petroleum and Natural Gas Licence. However, the provision would not be adequate if the CAPL Operating Procedure were used in the frontier areas.

F. *Clause 1011 — Independent Geological or Geophysical Operation*

Payment for data has been increased to 200% from 150%. However, the Clause only applies to geological and geophysical operations that were first offered for participation by a party pursuant to an operation notice; otherwise, the party conducting the operation has no obligation to offer the data to the other parties.

G. *Clause 1015 — Participation in Independent Operations*

The only change in this Clause concerns the failure of a participating party to reply to a notice by the proposing party asking whether it will assume its proportionate share of the percentage not assumed by a party limiting its participation. Failure to respond shall be deemed an election not to assume any additional percentage.

H. *Clause 1018 — Non-Participating Party Denied Information*

The Clause has been modified to state that a non-participating party is not entitled to have access to the wellsite or any information with respect to the well, in the case of a well that is drilling, until the non-participating party becomes a participant or upon the expiration of 90 days after rig-release date, whichever first occurs; or in the case of a well that has been drilled, until the non-participating party becomes a participant or upon the expiration of 120 days after receipt of the operation notice, whichever first occurs.

I. *Clause 1019 — No Joint Operations Until Information Released*

A party withholding well information pursuant to Clause 1018 cannot propose or conduct any joint interest operations on the joint lands within 3 miles (reduced from 4½ miles in the 1974 CAPL) of the well until it has released the information to the non-participating parties.

J. *Clause 1022 — Reversion of Zone or Formation Upon Abandonment*

This new clause provides for the re-assignment of all the interest in a zone or formation previously assigned or forfeited by a party under subclauses 1007(a) and (b) in the event a well is abandoned by a participating party.

ARTICLE XI — SURRENDER AND QUIT CLAIM OF JOINT LANDS

A. *Clause 1101 — Initiation of Surrender Proposal and Quit Claim of Interests*

The 1981 CAPL has expanded this Clause to cover quit claim actions by a party.

ARTICLE XII — ABANDONMENT OF WELLS

A. *Clause 1201 — Procedure for Abandonment*

Whereas failure to respond to an abandonment notice issued pursuant to the 1974 CAPL was deemed to be an election to participate in the abandonment, failure to respond to an abandonment notice under the 1981 CAPL is deemed to be an election to take over the well. As a result, the silent party may be required to pay the abandoning parties a portion of the salvage value of the materials and equipment appurtenant to the well in accordance with Clause 1202.

B. *Clause 1203 — Reversion of Zones Upon Subsequent Abandonment*

Reflecting similar changes in Clause 1022, this Clause provides for the re-assignment of the prior interests held in the spacing unit and formations to the non-participating parties upon a subsequent abandonment by the parties who took over the well.

ARTICLE XVII — CASH AND ACREAGE CONTRIBUTIONS

A. *Clause 1701 — Contributions to Joint Operations to be Shared*

While the 1981 CAPL excludes contributions from governmental sources in the calculation of the penalty set forth in clause 1007, it fails to make this exclusion in Clause 1701. The inherent danger in this omission stems from the "leakage" rules imposed under the Petroleum Incentives Program. Although it is probably understood by Joint-Operators that P.I.P. payments are not to be shared among high and low "COR" participants pursuant to Clause 1701, the failure to set forth an exception in Clause 1701 could lead to difficulties in claiming P.I.P. benefits.

ARTICLE XVIII — CONFIDENTIAL INFORMATION

A. *Clause 1801 — Information To Be Kept Confidential*

A party now has the right to release information to its affiliates, provided they are bound by the terms and conditions of the Agreement and the Operating Procedure, including Clause 1801.

ARTICLE XIX — DELINQUENT PARTY

A. *Clause 1902 — Effect of Classification as Delinquent Party*

It should be noted in subclause (c) that a delinquent party is now deemed to have elected to join with the Operator in all farmouts and assignments effected by the Operator. The delinquent party's interest in the farmouts and assignments effected by the Operator will be in proportion to its participating interest under the CAPL Operating Procedure.

ARTICLE XXIV — DISPOSITION OF INTERESTS

A. *Clause 2402 — Exceptions to Clause 2401*

In the event that a right of first refusal is retained by each of the Joint-Operators, Clause 2402 of the 1981 CAPL allows the disposition of interests in the joint lands without regard to that preferential right in the following circumstances:

1. pursuant to an assignment, sale or disposition made by a party of its entire participating interest in the joint lands to a corporation in return for shares in that corporation or to a registered partnership in return for an interest in that partnership, or

2. pursuant to an assignment, sale or disposition by a party in which the net acres being assigned, sold or otherwise disposed of by that party in the joint lands represent less than 5 per cent of the total net acres being assigned, sold or otherwise disposed of by that party pursuant to the transaction affecting its interest in the joint lands.

These exceptions were not provided for in the 1974 CAPL. One cannot help but wonder whether these new provisions effectively negate any right of first refusal purported to be retained by the Joint-Operators.

ARTICLE XXVII – MISCELLANEOUS

It should be noted that the 1981 CAPL has added the following new miscellaneous provisions:

1. Clause 2705 – Use of Canadian Funds,
2. Clause 2706 – Laws of Jurisdiction to Apply,
3. Clause 2707 – Use of Name

CONCLUSION

Since 1969, the oil and gas industry has looked to the CAPL Operating Procedure as a general reference document as well as a procedure to govern specific joint interest operations. As with any standard form document, it must be, and is expected to be, a continually developing document to meet the ever-changing needs of the oil and gas industry. The Association has indicated that the changes that will be made to the CAPL Operating Procedure will be those which the Association considers as having general acceptance and consensus in the industry and which befit the generic application of the document. Changes that serve a limited number of parties or needs of a specific situation should be made by the parties having those special needs. It is hoped that the foregoing comments will assist the Association in keeping the CAPL Operating Procedure as current and as useful as possible.