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SOLDIER SETTLEMENT LANDS

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Partnership Contribution Transactions and the Notice to Industry

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SO, TRUSTS ARE GONE AND PARTNERSHIP CONTRIBUTIONS ARE ALL THE RAGE. Not only did the trust guys need to create new partnerships to roll their trust (corporate) assets into last year, now it seems like everyone, not just former trusts, are on the partnership asset flip ride this year. Yahoo. Let's roll them assets again and again. Full speed ahead, the tax guys say we are saving like a bazillion dollars.

For landmen, the tricky little question is what to do about all the contracts in the file room. Do I need to prepare notices of assignment (NOAs) or assignment and novation agreements (A&Ns) for each and every contract file? Yuck. Or maybe, just maybe, I can get away with a Notice to Industry and call it a day.

I know there is constant pressure to keep G&A costs down, but why, dear Lord, why, do landmen and land lawyers sometimes give into the temptation to do half a job and hope no one cares. Don't get me wrong, I have three teenage boys at home. I am well aware of (and can appreciate) a skillfully delivered job half done. I have the worst mowed lawn on the block.

Short answer is, of course, you have to prepare NOAs for every single contract. Novation does not occur otherwise. Full stop. Don't be lazy. Eat your veggies. Long answer is as follows.

Two Types of Transactions

Oil and gas transactions fall into two categories:

- fancy pants merger and acquisitions (M&A); and
- grunt work acquisition and divestitures (A&D).

I have no idea how "acquisitions" made it into both categories. Very confusing. Someone needs to speak to the Acronym Committee and get this fixed.

M&A Novation Not Required

M&A are a mysterious and magical process whereby one entity (corporation or partnership) *becomes another entity* through operation of law. Very Zen. The process occurs through lots of documents, but ultimately you know a "merger" has occurred because an amalgamation or name change will appear at corporate registry.

No paper needs to be circulated to industry because, at law, no conveyance of assets has occurred. Party A is now Party B. All contracts and obligations of Party A are now the contracts and obligations of Party B.

In the old days (before the fabulous software product EnerLink was invented by a guy I know) companies would send out a Notice to Industry, as a courtesy, so everyone knew they had to update their internal vendor code from Party A to Party B. End of story.

A&D Novation Required

A&D transactions are fundamentally different. In A&D, a defined set of assets are conveyed from Party A to Party B. This is a private conveyance of beneficial ownership.

The typical sale transaction is not the problem. Everyone knows to prepare all the closing paper required to assign and novate the purchaser into the contracts and agreements formerly held by the vendor.

Partnership Contribution and Flips are A&D Transactions

For some odd reason (see lawn mowing example above), on a contribution to a partnership, or a contribution from one partnership to another partnership, some companies think they do not need to do any paper. Wrong.

Anytime you convey (or *contribute*) assets from Party A to Party B, you need to prepare a NOA (or A&N) for every contract file. It does not matter that:

- you are affiliated;
- the new party name sounds suspiciously like the old one; or
- you are all the same people working in the same office.

You will recognize this type of transaction by the ultimate dissolution (corporate) or winding up (partnership) of Party A. This will show up at corporate registry.

Privity of Contract and Novation

Now a bit of lawyer speech to make me sound serious. At law, unless Party A becomes Party B (see M&A above), third parties are not bound to recognize Party B unless and until they have agreed to release Party A from their contractual obligations and recognize Party B into the contract. These are the fundamental concepts of Privity of Contract and Novation.

Privity of Contract is the binding legal relationship between parties having an interest in the same matter under a contract. This means all legal rights and obligations are restricted to the parties formally recognized under the contract.

Novation means the existing parties to an agreement have agreed to substitute a new contract for the old one, substituting the assignor for the assignee. Novation ordinarily arises when a new individual assumes the obligation of an original party, who is thereafter released from its obligations under the agreement.

As stated by the Supreme Court of Canada in *National Trust v. Mead* as followed by the Alberta Court of Queen's Bench in *Canada Southern v. Amoco* (Alta Q.B. September 14, 2001):

> The common law has long recognized that while one may be free to assign contractual benefits to a third party, the same cannot be said of contractual obligations. This principle results from the fusion of two fundamental principles of

contract law: (1) that parties are able to make bargains with the parties of their own choice (freedom of contract); and (2) that parties do not have to discharge contractual obligations that they had no part in creating (privity of contract).

Therefore, in every contract, novation only occurs once all third parties to the contract have *agreed in writing* to release the current party (assignor) and recognize the new party (assignee). This is what the A&N does. Go find one and show it to the young kids in the office. They will be amazed. Then show them the fax machine.

The NOA: A Special Case

We, of course, decided that an actual written consent by third parties is too hard. So CAPL created the Industry Agreement, Assignment Procedure and NOA. Actually very cool. We are the only industry that allows novation to occur *without the written consent of third parties*. They must object or be bound. Special, special situation. Not the normal rule.

Why Not One Great Big NOA?

I fear that the long term use of the NOA has led some people to believe that written consent by third parties is a kind of optional activity. The thinking, I believe, goes like this: (1) well, a NOA isn't signed by third parties and is binding, right; (2) so why can't a Notice to Industry be like one big NOA. We just send it out to everyone and voila, novation occurs. Alternatively, there may be confusion in thinking that a partnership contribution or flip is really an M&A transaction since it is big and affects the whole company. Neither is correct. Honest.

Why You Should Care (Because the Tax Guys Said So)

Fear the Tax Man

Every single contribution transaction is being undertaken for the lovely tax deferral advantage. The deferral is created in large part through the underlying legal concept that you are contributing the assets from one party to another party. That is to say you cannot create the deferral without the contribution.

Ergo, papering the transaction as a true contribution (i.e. preparing NOAs and A&Ns) is considered a crucial piece of evidence indicating that a true contribution from one party to another occurred.

By issuing only a Notice to Industry and asking industry to update their records without NOAs you are pretty much shouting out loud hey, we aren't really doing anything but changing our name a bit to defer some tax. Thanks.

The last thing you want to do is to assert a true contribution but do a crappy job mowing the lawn. The tax man will not be amused. I am not a tax lawyer, but I have yet to hear one of them say don't worry about the paper, a Notice is good enough. I guess my boys will not grow up to be tax lawyers.

Respect Novation

As a land lawyer, the real issue for me is not the tax consequence, but rather respecting the fundamental concepts of Privity of Contract and Novation. We need to do our jobs well.

Apart from doing the right thing, the failure to respect these basic rules means that:

- contractual obligations such as JIBs, invoices, share of rentals, and environmental and reclamation costs; and
- contractual benefits such as revenues and the right to propose independent operations;

can be assumed by parties who are not properly novated into the contract. If something ever goes wrong, a Court will show no sympathy to a company that updated their records incorrectly. No short cuts are allowed.

Soooo, when you decide to be lazy and update your vendor code on a partnership contribution based on a Notice to Industry and not the underlying NOA, you take the risk that you are charging and paying the wrong party. Tough to deal with in practice I know. Same office, same people, why should I care? I bet that is what they said in the accounting meeting. I am just letting you know the risks. You get to fight with accounting.