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To Supersede or Not to Supercede
Handling Prior ROFRs and Subsequent Non Cross-Conveyed Poolings

CAPL Member Profile
Bob Garies, 2008 Herb Hughes Memorial Award Recipient

Prior ROFRs and Subsequent Non-Cross Conveyed Poolings

(To Supersede or Not to Supersede, That is the Question)

I HAVE DECIDED TO TAKE A BREAK FROM FREEHOLD LEASE ISSUES THIS MONTH AND MUSE ABOUT RIGHT OF FIRST REFUSALS (ROFRS) in prior agreements where you have a subsequent Non-Cross Conveyed Pooling Agreement. This issue has come up three times in a month in our little shop and I was completely amazed by the divergent views and strong opinions by the lawyers in our office. There was even shouting and mad staring. Totally cool. Nice to see some drama in our rather boring office lives.

Suffice it to say this article comes with the disclaimer that I certainly do not have the answer to the question. So if you prefer closure in your casual reading time, you may want to skip ahead to the next article.

The Single ROFR Situation

The simplest version of this ROFR conundrum arises where:

- a prior contract (such as a JOA) exists on the lands and the attached 1990 CAPL Operating Procedure has a 2401B election, such that a ROFR exists in the JOA;
- a subsequent non-cross conveyed Pooling Agreement is entered into with respect to some or all of the lands in the JOA and the attached 1990 CAPL Operating Procedure has a 2401A election, such that the Pooling Agreement does not have a ROFR; and
- a recognized party to the Pooling Agreement agrees to sell its pooled interest to a third party purchaser.

The Rule of Superceding Contracts

The general legal rule where you have a subsequent contract with:

- at least the same parties;
- the same lands; and
- the same subject matter,

is that the prior contract (i.e. the JOA) is "superceded" by the subsequent contract (i.e. the pooling agreement) with respect to all lands and matters dealt with in the subsequent agreement. This legal principle is codified in all of the CAPL Operating Procedures, including clause 2801 of the 1990 CAPL Operating Procedure which states:

> ... this Operating Procedure supersedes all other agreements, documents, writings and verbal understandings among the parties relating to the joint lands and any production facilities, and expresses all of the terms and conditions agreed upon by the parties with respect to the joint lands and any production facilities.

Therefore, under the rule of superceding contracts, the Operating Procedure to the Pooling Agreement supersedes the Operating Procedure to the JOA. As both Operating Procedures contain the Article 24 consent or ROFR provision, it is arguable that the 2401A (consent) election in the Pooling Agreement supersedes the 2401B (ROFR) election in the JOA.

It is even possible to argue that the entire subject matter of the JOA no longer applies to the pooled lands and the JOA has terminated with respect to same. This often leads to the industry practice of no longer preparing notices of assignment (NOA) or other assignment documents in relation to the prior JOA. Often the JOA file is deemed no longer active and is cancelled from a company's land system.

Cross Conveyance of Interests

The rule of superseding contracts works for all subsequent Pooling Agreements that affect a cross conveyance of interests between the parties. These are the magic words "combine and cross convey" that appear in most old pooling agreements and all JOAs and Farmout Agreements. The parties agree to permanently convey and combine their respective working interests in the joint lands and agree to a new Operating Procedure with respect to the joint lands. Under such agreements there is no possible argument that the ROFR in the underlying agreement survives and is active.

I like to think of superceding contracts as that magical moment when you are in your late teens (or 25 years old in my case) and you tell your mom you are going to move in with your girlfriend (fiancée really, but I don't think my mom appreciated the difference). The point is that as soon as you enter into this new agreement, your prior agreement with your mom (i.e. food, shelter and laundry) is over. No going back, ever (at least with Catholic parents). Your new contract supercedes the mom contract.

Exception to the Rule – Unit Agreements

Exceptions to the general rule of superseding contracts arise where the subsequent agreement does not encompass the entire subject matter of the prior agreement, such that the prior agreement continues to exist even though a subsequent agreement has been entered into between the same parties and the same lands.

The classic example of such an agreement is the unit agreement. Where parties to a JOA agree to become parties to a unit agreement with respect to joint lands, the unitized zones become subject to the unit agreement and the unit operating agreement. For example, you can no longer issue independent operation notices under the JOA as you are now bound by operating committee and mail ballot rules in the unit operating agreement. However, unitization is almost universally understood to be merely a method of revenue sharing among parties and not a cross conveyance of interests. Accordingly,

the underlying JOA is not superceded as the entire subject matter of the JOA is not encompassed in the unit agreement. Therefore, any provisions in the JOA not expressly dealt with in the unit operating agreement continue to be in full force and effect. This almost certainly means that ROFRs on the underlying working interest in the JOA must continue to be issued on any sale of such an interest.

This leads to the industry practice of continuing to prepare NOAs or other assignment documents in relation to the prior JOA. The prior JOA file remains active and is not cancelled from a company's land system.

Think of the situation where you tell your mom you are moving in with some buddies. Such a situation may lead to a new operating arrangement with your buddies that relates to most of the prior functions of your mom while living at home. However I doubt anyone in such a bachelor pad ever felt like they were married. Most guys clearly understand that the underlying mom agreement remains, and in the event of even a minor hardship they will reclaim the reversionary right to go home. Clearly, your buddy agreement does not supersede the mom contract.

Non-Cross Conveyed Pooling Agreements

Non-cross conveyed Pooling Agreements sit awkwardly between a true superseding contract and a lesser revenue sharing type agreement that does not encompass the entire subject matter of the underlying JOA. Clearly all the magic words in a non-cross conveyed pooling agreement state that the parties do not cross convey. The agreement typically will "terminate" after all wells in the pooled zone have been abandoned and thereafter the lands will "revert" to the parties as to their pre-pooled working interests. So, the rule of superseding contracts will not apply to the underlying JOA.

However, the Pooling Agreement will almost always attach a full CAPL Operating Procedure, including clause 2801 quoted above and a 2401A election. The question then really boils down to whether the selection of 2401A in the Pooling Agreement Operating Procedure sufficiently deals with the ROFR "subject matter" of the non-superseded JOA, such that the ROFR provision no longer applies.

We are split here at the office and apparently in industry in this issue. For example, see "Part III Miscellaneous Annotations on ROFRs", being paragraph 5 of the Annotations to the 2007 Operating Procedure, which states pretty much what I am saying here. Houston, we have a problem.

The No ROFR Approach

My historical practice was to assume the Operating Procedure to the Pooling Agreement superseded the JOA ROFR. Obviously not clear, however I felt that the act of the pooled parties entering into a full new Operating Procedure likely signified an intent to supercede all provisions of the prior Operating Procedure. I understood that the non-cross conveyed Pooling Agreement was merely a revenue sharing agreement, however my thinking was that so long as the JOA fully deals with a particular subject matter (such as consent versus a ROFR), it is superseded by the Pooling Agreement for the duration that the pooling is effective (much like the elimination of ION provisions upon unitization).

The ROFR Approach (When in Doubt Send it Out)

The problem with such an approach is that it ignores the legal status of the reversionary working interest that remains the subject matter of the JOA. This reversionary interest is expressly excluded from the subject matter of a non-cross conveyed Pooling Agreement. Therefore, the administration of the interest cannot be dealt with in the Operating Procedure to the Pooling Agreement. If it cannot be dealt with under the Pooling Agreement, then surely a ROFR pertaining to the reversionary working interest must be issued whenever a party intends to dispose of its pooled interest.

Annoyingly concise logic. Annoyingly not my view, but rather the view of my colleagues. My clever responses of "so what" and "you're stupid" did not seem to alter their point of view. So, I have changed my practice and now I will err on the side of caution and issue ROFRs on the underlying reversionary working interest where practical to do so.

The Art of File Review

This pro-ROFR approach is certainly not fool proof and we often receive complaints from third parties indicating they have terminated the underlying JOA and do not recognize the ROFR. Worse is when there is a chain of NOAs from the Pooling Agreement but no

corresponding NOAs for the JOA. To issue a ROFR to outdated JOA parties may create a bigger problem than ignoring the ROFR.

So in practice, I recommend a nuanced pro-ROFR approach based upon a review of the prior conduct of the parties to the JOA and Pooling Agreement. Where you have a number of NOAs in the pooling file over time and termination of the underlying contracts (or at least no ROFRs issued) you need to seriously consider the risk of issuing a ROFR, even if it is the right thing to do.

In the Future I Pledge to Think Harder

The 2007 CAPL Operating Procedure Annotation for clause 1.11 contains the following warning to landmen:

> Care must be taken when preparing a non-cross-conveyed pooling agreement. To what degree will the initial agreement for a tract remain active for the Parties holding those rights? This issue is particularly relevant if the original agreement included a ROFR...

My warning would be a bit more direct. Something like:

> Never use a non-cross conveyed pooling agreement unless you have a really good reason for doing so, which you don't, so just stop it. Get out the old cross conveyed pooling agreement. It's fine. Quit trying to be so clever, you're just causing problems for everyone.

However, I feel I am starting to rant again so I will stop. If you insist on using a non-cross conveyed Pooling Agreement you need to amend your head agreement to state something like:

> This agreement specifically supersedes the entire Operating Procedure attached to the JOA dated XXX (the "Prior JOA") for the duration of this agreement, including without limitation, the preferential right of purchase contained in clause 2401B of the Prior JOA.

Paul Negenman

Alberta Beef

They say to buy land, because they're not making it anymore

THAT IS A FACT; EVEN HERE IN ALBERTA OUR ENTREPRENEURIAL SPIRIT TELLS US JUST ABOUT ANYTHING IS POSSIBLE. It's also a fact that the province's two main industries – energy and agriculture – must try and operate on the same, and increasingly more crowded land—and not always in harmony.

For several years now the Energy Resources Conservation Board (ERCB) has tried to bring the harmony back by playing the part of mediator through its Appropriate Dispute Resolution (ADR) program. And the ERCB is inviting you to contact its ADR staff to explore opportunities and build a better relationship if you're having difficulty in reaching an understanding with another energy company.

An important part of the ERCB's mandate is regulating Alberta's resources in the public interest, and ADR is a key part in reaching this goal. Stakeholders and oil and gas companies find their own unique solutions that balance different interests and, in that way, reach their own version of "the public interest" that fits their specific situation.

The ERCB's ADR program, which got off the ground in 2001, is stronger than ever. Late last year the Government of Alberta passed legislation to restructure the Alberta Energy and Utilities Board, and on January 1, 2008, the ERCB was reestablished as Alberta's oil and gas energy regulator. This change has benefited the Board's ADR capabilities as more resources have been allocated to the program, allowing it to hire additional fulltime staffers.

The ADR program can be requested by any affected parties when concerns and objections remain outstanding following negotiations between landowners and companies, and sometimes between the companies themselves. Most disputes resolved through the ADR process relate to proposed facility applications (wells, pipelines, and plants).

ADR directly involves the parties; they work collaboratively to reach mutually agreeable solutions. ADR helps both sides develop