

PETROLEUM ACCOUNTANTS SOCIETY OF CANADA

**Frequently Asked Questions about the
New Limitations Clause
for the Oil & Gas Industry
and the
Industry Agreement regarding Limitations**

Last Updated on: January 11, 2001¹

This document is intended to answer certain frequently asked questions regarding the new limitations clause proposed for the oil & gas industry, and the Industry Agreement regarding Limitations. It will be updated regularly as other questions arise. Check the PASC website ("www.petroleumaccountants.com") for the most current version.

For additional information regarding the new limitations clause and the Industry Agreement regarding Limitations, please review the "PASC Commentary on the New Limitations Clause for the Oil & Gas Industry and the Industry Agreement regarding Limitations", which is also available at the PASC website.

Questions about the New Limitations Clause

Q: *Is a revised limitation clause really necessary? Industry agreements contemplate the delivery of audit exceptions up to 26 months after the end of a calendar year. Isn't that enough of an indication under the new Limitations Act that the parties intended that the limitation period be extended?*

A: It is unlikely that the audit provisions contained in industry agreements constitute a sufficient indication of the type contemplated by the *Limitations Act* that the right to bring an action has been extended. Even if it did, at best the extension would be for the 26 month period after the end of a calendar year. That is not a sufficient extension period; the delivery of audit exceptions is only the beginning of the process that might ultimately lead to litigation. A longer time period is required, as provided for in the new limitations clause.

Q: *The proposed new limitations clause is in fact two different clauses: one for agreements which contain audit provisions requiring the conduct of an audit by a specified time, and another for agreements that do not contain such a provision. Why has this been recommended?*

A: The Limitations Task Force consulted extensively with industry in the preparation of the new limitations clause. The limitations problem is particularly apparent with respect to the audit process widely used in the oil & gas industry. Persons involved with that process felt strongly that the revised limitation clause should establish a date certain by which court action for an audit claim must be commenced, rather than dealing with the uncertainty of when a party "knew or ought to have known" of the claim. This goal is achieved in the new limitations clause by

¹ See the boldface headings below for the questions that have been added since the January 2, 2001 version of this FAQ document.

providing that claims identified in an audit may be commenced within two years after the period during which the audit was permitted to occur. Claims that are not disclosed in an audit, or claims arising under agreements that do not contain audit clauses that establish a specified time for conducting an audit, are not affected by the special audit limitation period; in those situations, the new limitations clause would establish a limitation period of four years from when the party knew or ought to have known of its claim.

Q: Under the old Limitation of Actions Act, a party was entitled to bring in action for breach of contract up to six years after the breach. Why does the new limitations clause specify a four-year period instead of a six-year period?

A: This matter was discussed at length by the Limitations Task Force. Some took the view that the limitation period should be for six years from when a party knew or ought to have known of its claim. This would make it consistent with the limitations rules in British Columbia, Saskatchewan and Ontario. However, others took the view that the limitation period should be as short as reasonably possible, and a four-year period seemed appropriate in the context of the processes of the oil and gas industry. The pace of change and personnel turnover in the oil and gas industry would make it preferable that claims are not outstanding for long periods of time. In approving a four-year period for the new limitations clause, the Board of Directors of PASC also took note of the fact that the new *Limitations Act* suggested a policy approach of shortening limitation periods.

Q: Does the new limitations clause apply only to claims made in connection with an audit?

A: No, it applies to all claims, whether in contract, tort, property or trust, and whether discovered in connection with an audit or not.

Q: Can we amend the new limitations clause?

A: It was the objective of the Limitations Task Force that a single limitations clause be created for use throughout the industry. It is hoped that industry will use this clause in all its future agreements so as to establish an industry standard that is widely known. However, the parties to a particular agreement are always free to establish or change the terms of that agreement, so it is possible to amend the new limitations clause.

The following question and answer about the new limitations clause has been added since the January 2, 2001 version of this FAQ document:

Q: Is the extension of the limitation period in conflict with the provisions of the Limitations Act?

A: No, section 7 of the *Limitations Act* specifically allows the parties to an agreement to extend the limitation period established under the Act.

Questions about the Industry Agreement regarding Limitations

Q: *Why does the Industry Agreement regarding Limitations establish a deadline for execution of February 15, 2001?*

A: The new *Limitations Act* came into force in Alberta on March 1, 1999. Until March 1, 2001, certain transitional provisions of the *Act* apply, entitling parties to the shorter of the limitation period under the new *Act* and the limitation period under the old *Limitation of Actions Act*. On March 1, 2001, the new *Act* is fully in effect, and parties have no longer any right to commence an action under the rules of the old *Act*.

This means that oil and gas companies must commence an action before March 1, 2001 to protect any claim that they knew or ought to have known of before March 1, 1999. There are many such claims; one industry member has indicated that it has more than 330 outstanding audit queries that predate that time. Moreover, many audits have not yet been commenced for the 1999 calendar year, yet some claims for the first three months of that year may be about to expire even though an audit has not yet occurred.

The Industry Agreement regarding Limitations will resolve many of these problems. However, we do not know which companies will sign the Industry Agreement, and therefore we do not know which agreements will be amended. By establishing a deadline for execution of the Industry Agreement that is prior to March 1, 2001, industry members can be informed about which agreements have been amended by the Industry Agreement in sufficient time to take some steps to protect claims that might exist under agreements that have not been so amended.

Q: *Is it possible for a company to sign the Industry Agreement regarding Limitations after February 15, 2001?*

A: No. The Industry Agreement regarding Limitations represents a one-time opportunity for industry to revise the limitations provisions of a broad class of existing agreements in a single document.

Q: *Must all the parties to a particular agreement sign the Industry Agreement regarding Limitations in order for that agreement to be amended?*

A: Yes, all the parties to a particular agreement on February 15, 2001 must sign.

Q: *What can I do to deal with potentially expiring claims under a particular agreement if my company does not sign the Industry Agreement regarding Limitations, or if another party to that particular agreement does not sign the Industry Agreement?*

A: There are a number of options. If you are aware of a particular claim that might expire, you may commence an action in respect of that claim, or obtain a waiver from the other party or parties to that claim that they will not raise the *Limitations Act* as defense to the claim. Some companies are seeking blanket waivers or standstill arrangements with their industry partners.

Alternatively, you could negotiate a specific amendment to the particular agreement that would extend the period provided for under the *Limitations Act*.

Q: *Does the Industry Agreement regarding Limitations resolve all limitations problems that would be statute-barred on March 1, 2001?*

A: No. Industry must bear in mind that replacing the provisions of the old *Limitation of Actions Act* (which established a six-year period for bringing actions for breach of contract, a ten-year period for bringing actions for recovery of property and an unlimited period for bringing actions for breach or trust) with the new limitations clause (which establishes a four-year limitation period after a party knew or ought to know of a claim, and a specific rule for claims disclosed in an audit) will still result in some claims potentially being statute-barred. Industry members will need to consider each particular claim to determine whether the new Limitations Act and the new limitations clause will be sufficient to entitle them to bring a claim after March 1, 2001.

By way of example, it is possible that an audit claim in respect of activities conducted under a joint operating agreement in the calendar years 1995 and 1996 (and which would not yet be statute-barred under the old *Act*) may be statute-barred after March 1, 2001 even if the joint operating agreement is amended by the Industry Agreement regarding Limitations. This would be true if the injured party "knew or ought to have known" of the existence of that claim at the time it arose.

Q: *My company sold the properties that are governed by a particular operating agreement, but the buyer has not yet been novated into that agreement. Signing the Industry Agreement regarding Limitations might have the effect of amending that agreement. Is my company entitled to do that when it is no longer the beneficial owner of the rights governed by that agreement?*

A: The Industry Agreement regarding Limitations addresses this issue specifically. If your company has agreed to transfer an agreement, but the novation process is not yet complete, your company can still sign the Industry Agreement regarding Limitations. If the transferee of the agreement also signs the Industry Agreement regarding Limitations, then no issue arises regarding your authority to amend the particular agreement in question. However, if the transferee does not sign the Industry Agreement, the Industry Agreement permits you to send a notice to the other parties to the particular agreement that it is excluded from the Industry Agreement because the transferee did not sign. This notice must be sent by February 23, 2001.

Q: *Is it possible for my company to sign the Industry Agreement regarding Limitations but exclude its application to a particular agreement or class of agreements?*

A: No, except for the specific situation described in the preceding question.

Q: *Does the Industry Agreement regarding Limitations amend unit agreements?*

A: While unit agreements may fall within the definition of "Agreement" under the Industry Agreement regarding Limitations (and therefore fall within the class of agreements that are

amended by the Industry Agreement), it is important to remember that only agreements which are signed by all the parties will be successfully amended by the Industry Agreement. No effort is being made to seek execution of the Industry Agreement regarding Limitations by the Alberta Crown or by individuals. Accordingly, any unit agreements to which the Alberta Crown or individual lessors are a party would not be successfully amended by the Industry Agreement. This constitutes essentially all unit agreements. It is possible that unit agreements where all of the lessors are corporations may be amended if those corporations sign the Industry Agreement.

It is expected that many unit operating agreements will be amended by the Industry Agreement regarding Limitations.

Q: Does the Industry Agreement regarding Limitations amend agreements for the purchase and sale of oil and gas properties?

A: It seems unlikely that typical agreements for the sale and purchase of oil and gas properties would fall within the definition of "Agreement" in the Industry Agreement. Accordingly, it is not appear that such agreements would be amended by the Industry Agreement.

Many typical agreements for the sale and purchase of oil and gas properties contain a provision that prohibit claims under the agreement unless the defaulting party receives a notice of the claim on or before specified date. Even if the Industry Agreement did amend agreements of this type, the new limitations clause would likely not alter this notice requirement.

Q: My company has included limitations provisions in many of our agreements since the Limitations Act came into effect in March, 1999. If we sign the Industry Agreement regarding Limitations, what limitation period applies- the one in the Industry Agreement, or the one written in our agreements?

A: The Industry Agreement regarding Limitations provides that where a particular agreement already contains an extension to the limitation period, the applicable limitation period will be the greater of that provided for in the particular agreement and that provided for in the new limitations clause contained in the Industry Agreement.

Q: If there are certain provisions of the Industry Agreement regarding Limitations that my company does not like, can we amend it?

A: No. The Industry Agreement must be signed "as is", and a party may not impose conditions on the delivery of its counterpart execution page.

The following questions and answers about the Industry Agreement regarding Limitations have been added since the January 2, 2001 version of this FAQ document:

Q: Which companies have received the Industry Agreement regarding Limitations from PASC?

A: PASC sent a copy of the Industry Agreement (and the PASC Commentary and Limitations FAQ) to every company in the "Explorers and Producers" section of the current electronic version of Nickle's *Canadian Oil Register*. Where a company showed multiple contacts, PASC mailed the package to one person at the company, with that person determined in the following priority of position: Vice President Operations, Vice President Production, Chief Operating Officer, Chief Executive Officer, and President.

PASC has also been seeking to distribute the Industry Agreement and related documents through various industry associations such as CAPLA, PJVA, CAPP, CAPP and others, however distribution in this manner has not yet been completed as of January 11. It has also been sent to all members of PASC.

Q: *How will persons who are not listed in Nickle's Canadian Oil Register receive the Industry Agreement regarding Limitations?*

A: It is hoped that oil and gas companies who support the Industry Agreement will review their list of industry partners and request that they execute the Industry Agreement. If that list includes companies or individuals who have not received a copy of the Industry Agreement, they are free to download it from the PASC web site ("www.petroleumaccountants.com"), print it, sign it and send it to PASC.

Q: *Will the Alberta Crown be a party to the Industry Agreement regarding Limitations?*

A: No attempt has been made by PASC to seek execution of the Industry Agreement by the Alberta Crown.

Q: *Does PASC intend to make an effort to persuade companies who have not signed the Industry Agreement regarding Limitations to do so?*

A: PASC is seeking to distribute the Industry Agreement widely within the oil and gas industry. PASC is also promoting the document with other industry associations, and PASC representatives are making presentations at various industry functions. However, PASC does not have the personnel to call individual companies to encourage execution of the Industry Agreement. Whether or individual companies wish to amend their oil and gas agreements is entirely their decision. It is hoped that oil and gas companies who support the Industry Agreement will encourage their industry partners to do so as well. This was the process followed in 1993 in connection with the Industry Agreement regarding Novations, which led to 2400 companies signing that agreement.

Q: *My company is negotiating an agreement that falls within the scope of the term "Agreement" in the Industry Agreement regarding Limitations. We do not expect that the agreement we are negotiating will be fully signed on February 15, 2001, but it will be backdated to an earlier date. Does the Industry Agreement amend documents which are not signed on February 15, 2001 but which are backdated before that date?*

A: The Industry Agreement defines the class of documents which can be amended by it as "Agreements". An "Agreement" is defined in part as an agreement which "is effective before February 15, 2001". Whether or not a particular agreement which is not executed on that date can be said to be effective before that date depends upon a number of circumstances, including the intention of the parties, part performance and other matters. It cannot be concluded with certainty that the Industry Agreement effectively amend an agreement that has not been signed on February 15, 2001. If your company is still negotiating this agreement, consider including the provisions of the new limitations clause directly in the document.

Q: *My company has signed the Industry Agreement and sent it to the PASC office. What happens now?*

A: Within a few days after receipt of your signed counterpart of the Industry Agreement, PASC will sign a counterpart and send it to you. Shortly after January 31 and February 15, 2001, PASC will send you a list of the parties who have signed the Industry Agreement.

Additional Questions

Should you have any further questions or comments about the new limitations clause or the Industry Agreement regarding Limitations, please contact the Petroleum Accountants Society of Canada:

Petroleum Accountants Society of Canada
1500, 888 - 3rd Street S.W.
Calgary, Alberta T2P 5C5
(403) 262-4744 (B)
(403) 265-4573 (F)
Email: info@petroleumaccountants.com

For up-to-date news about the Industry Agreement regarding Limitations, check the PASC website ("www.petroleumaccountants.com") regularly.

J. Jay Park
Director, PASC
January 11, 2001