

## **PJVA EARLY MORNING DISCUSSION**

Wednesday, September 27, 2006

CO&O Agreement Issues

Linda Green's Notes

1. Silent Partners – rights/obligations, Operator indemnity, ROFRs.

### What is a silent partner?

A silent partner is a party who is not included in the Facility Participation appendix but owns an interest in the Facility through an arrangement it has with a recognized Owner in the Facility. This arrangement can occur:

- (i) at the time that the original AFE from Operator was raised to build the Facility; or
- (ii) at some later point, particularly if the silent partner becomes a participant (silent or otherwise) in a well or wells that deliver to the Facility.

### What rights and obligations does a silent partner have?

Under the CO&O, none. It does not fall under the definition of Owner which “is a party to this Agreement”. The only connection it has to the CO&O is via the trust agreement or other arrangement it has with the “real” Owner. The Owner who has a silent partner will be held accountable for any damages created by the silent partner who is, for all intents and purposes, invisible.

### Operator indemnity

Operator is covered by the indemnification given to it by the owner who is party to the Agreement.

### ROFRs

Because the silent partner is not party to the CO&O, it has no ROFR rights. In fact, in setting up the silent partner the Owner has breached its own ROFR. In fact, having a silent partner can be somewhat of a hindrance in selling an asset, because the seller will likely want the purchaser to assume the obligations with respect to the silent partner under the trust agreement or other arrangement it has with the silent partner.

### Solution

Full disclosure of silent partners and inclusion in Appendix I.

### Risks

Silent partners are invisible. They could remain that way indefinitely, but frequently come to light when they start to take in kind. At that point Operator will be well within its rights to treat them as third parties and expect them to enter into a third party service agreement and pay fees for usage of the Facility. Simply providing a copy of the trust agreement or other documentation to substantiate their ownership is not sufficient because Operator is not privy to the agreement or documentation. That being the case, Operator cannot assume that the arrangement is still in place. One option to avoid fees is for the “real” Owner to “dispose” of an interest to the silent partner. However, the ROFR may be exercised on by another “real” Owner. There is absolutely nothing to protect the silent partner under the CO&O as there are no exceptions for silent partners. Another option that might work is a one-time “amnesty” type agreement allowing all of the silent partners to be recognized as Owners. In this case 100% of the current “real” Owners would have to agree to this. If the mail ballot process is used, votes cannot be deemed if any of the Owners fails to vote.

2. Assignment Issues – notices, retroactive effective dates and retroactive use of Capacity

Notices

A NOA, specific assignment, a copy of the P & S agreement or a letter signed by both parties can constitute “notice” as long as it evidences the change in ownership and is signed by both parties. If the purchaser is not already an Owner, the CO&O may require consent by the other Owners to allow it to become an Owner. In all such cases, a cp executed by the new Owner is required.

Retroactive effective dates

There is no such thing as a retroactive effective date. The CO&O states that “every disposition of an interest..... shall not be binding on the other Owners until the first Day of the Month next following receipt of the required documentation”.

Retroactive use of Capacity

Until the effective date recognized by the Owners, the new Owner is a third party custom user. It is not exempt from third party fees nor does it have any right to use Capacity regardless of the effective date it has established in its purchase and sale agreement with the former Owner.

3. Changes to Appendices – voting vs. fact

I. Facility and Functional Unit Participation

- voting not applicable, amended as a consequence of ownership changes, addition of new Functional Units

II. Description of Facility and Functional Units, Map and Schematic

- voting not applicable, amended as a consequence of addition of new Functional Units or changes to existing ones

III. Accounting Procedure

- requires approval at Facility Participation, never at Functional Unit participation

IV. Structure and Sharing of Joint Account

- should be at Functional Unit or Facility Participation (if only one Functional Unit)

V. Capacity Usage

- should be at Functional Unit or Facility Participation (if only one Functional Unit)

VI. Insurance

- requires approval at Facility Participation, never at Functional Unit participation

VII. Specifications of Inlet Substances and Facility Products

- should be at Functional Unit or Facility Participation (if only one Functional Unit)

VIII. Facility Product Allocation Procedure

- should be at Functional Unit or Facility Participation (if only one Functional Unit)

IX. Measurement

- requires approval at Facility Participation, never at Functional Unit participation

X. Investment Values

- voting not applicable, amended as a consequence of addition of new Functional Units or changes to existing ones

XI. Enlargement

- requires approval at Facility Participation, never at Functional Unit participation

XII. Dispute Resolution

- requires approval at Facility Participation, never at Functional Unit participation

XIII Wells

- voting not applicable, amended as a consequence of changes, addition of new wells

XIV Environmental Matters

- requires approval at Facility Participation, never at Functional Unit participation

4. Execution of Agreements – managing counterparts

Only Operator requires a full set of original counterparts. The Head Document states that "The Operator shall promptly supply each Owner with **copies** of a full set of counterpart execution pages.

5. Handling of Appendices – delete vs. N/A

Deleting appendices that are not being used (WELLS is frequently not used for instance) creates more work because the remaining ones need to be renumbered and cross references may have to be checked and changed. If an appendix title is deleted any references to that appendix will have to be deleted and noted in Elections and Modifications if they are in the body of the Operating Procedure.