A.S.C. POLICY 4.6
OIL AND GAS PROGRAMS

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PREAMBLE

This policy is issued as a guide to persons and companies wishing to qualify a prospectus with the oil and gas program through a distribution of securities. The Commission and the Director of the Commission (the "Director") will always exercise their discretion in applying the guidelines contained in this policy and, in exercising their discretion, may modify or waive certain guidelines while still remaining consistent with the spirit of the policy if, in their opinion and in light of the entire fact situation, circumstances justify variation therefrom.

1. GENERAL

1.1 *Application*

The type of entity to which these guidelines apply will ordinarily be limited partnerships formed under the Partnership Act (Alberta) R.S.A. 1980, c. P-2 which have been set up to benefit from incentives offered under federal and provincial income tax legislation for the exploration and development of Canadian oil and gas reserves. This policy may by analogy be applied to entities using other forms of organization, including trusts or contractual arrangements made under common law.

Although such entities are often known as "drilling funds" they are referred to as "drilling programs", "production programs" or "programs" throughout this policy so as to avoid any possible confusion with the mutual fund industry. The word "fund" to describe a program will not be allowed in a prospectus.

This policy is issued as a guide to persons wishing to qualify a prospectus with the Commission for the purpose of financing, directly or indirectly, an oil and gas program through a distribution of securities to the public.

1.2 *Form*

The contents of a prospectus for a program should comply with Form 14 of the Regulations (the "Regulations") to the Alberta Securities Act (the "Act") although

presentation need not follow the order set out therein. These guidelines describe Commission policy on particular aspects of programs and on specialized disclosure requirements for certain item numbers in Form 14 (referred to in these guidelines as "Item").

1.3 *Definitions*

The following terms are not defined in the Act or the Regulations but shall have the following meaning in this policy:

1.3.1 "Area of Mutual Interest" means an area of mutual interest comprising

1.3.1.1 any of the eight sections of land contiguous to the section containing the prospect to be drilled by the program and the section containing such prospect, and

1.3.1.2 any offsetting lands which, although not within the eight contiguous sections, would be within the geological limits of the prospect,

but in either case contiguous and offsetting lands need not include any “proved producing reserves" as defined in the Regulations.

1.3.2 "Assessments" means additional amounts of capital which may be mandatorily required of or paid voluntarily by participants beyond their subscription commitment.

1.3.3 "Canadian Exploration Expense" and "Canadian Development Expense" means expenses as described under Section 66, or any amendment thereto, of the Income Tax Act (Canada) and briefly summarized as follows:

1.3.3.1 Canadian exploration expenses are those expenses including geological, geophysical or geochemical expenses which, during the year or under certain circumstances in previous years (since May 6, 1974) were incurred for the purpose of determining the existence, location, extent or quality of an accumulation of petroleum and natural gas in Canada. Also included are expenses involving drilling and the construction of temporary access roads in respect to a well that is completed within 6 months after the year-end and can be shown to be the first producing well from a newly discovered pool of gas and oil, or which is not expected to come into production in commercial quantities within 12 months of its completion;

1.3.3.2 Canadian development expenses are those drilling and related expenses which do not qualify as Canadian exploration expenses and include the cost of a Canadian resource property.

1.3.4 "Canadian Resource Property" means any property acquired after 1971 as defined in section 66(15)(c), or any amendment thereto, of the Income Tax Act (Canada) and related to oil and gas programs in Canada and summarized as follows:

1.3.4.1 any right, licence or privilege to explore or drill for petroleum and natural gas in Canada,

1.3.4.2 any oil or gas well situated in Canada,

1.3.4.3 any rental or royalty from an oil or gas well situated in Canada or

1.3.4.4 any right to or interest in any oil and gas property (other than property of a trust) described in items 1.3.4.1, 1.3.4.2 and 1.3.4.3 including a right to receive proceeds from disposition thereof.

1.3.5 "Capital Contributions" means the total investment, including the subscription commitment, assessments and amounts reinvested, in a program by a participant or by all participants, as the case may be.

1.3.6 "Capital Expenditures" means expenditures which bring into being an asset of permanent and enduring advantage which is subject to capital cost allowance as permitted by Regulation under the Income Tax Act (Canada) and not allowable as a current expense.

1.3.7 "Cost" means

1.3.7.1 with respect to a property in item 7.8

1.3.7.1.1 the sum of the prices paid by the seller for such property, including bonuses,

1.3.7.1.2 title examination costs, brokers commissions, filing fees, recording costs, transfer taxes (if any), and like charges in connection with the acquisition of such property, and

1.3.7.1.3 rentals and ad valorem taxes paid by the seller with respect to such property to the date of its transfer to the

buyer, interest on funds; used to acquire or maintain such property, and such portion of the seller's reasonable, necessary and actual expenses for geological, geophysical, seismic, engineering, drafting, accounting, legal and other like services allocated to the property in accordance with generally accepted industry practices, except for expenses in connection with the past drilling of wells which are not producers of sufficient quantities of oil or gas to make commercially reasonable their continued operations. The expenses enumerated in item 1.3.7.1.3 shall have been incurred not more than 36 months prior to the purchase of the property by the program or such longer period as the Director, in his discretion, may allow upon proper justification.

1.3.7.2 with respect to services, the reasonable, necessary and actual expense incurred by the seller on behalf of the program in providing such services, determined in accordance with generally accepted accounting principles.

1.3.7.3 as used elsewhere, the price paid by the seller in an arm's-length transaction.

1.3.8 "Development Well" means a well classified as, such under the Lahee system for classification but in general terms is a well normally drilled as an additional well to the same pool as other producing wells, or an offset well usually not more than one spacing unit away from a well producing from the same pool, and may include a service well.

1.3.9 "Drilling Program" means any program which is not a production program.

1.3.10 "Exploratory Well" means a well classified as such under the Lahee system for classification but in general terms is a well normally drilled more than one spacing unit away from another well producing from the same pool either in search of a new and as yet undiscovered pool or field of oil or gas (or with the hope of greatly extending the limits of a pool already developed), or drilled within a pool with the object of discovering new producible formations at a greater depth.

1.3.11 "Farm-Out" means an agreement whereby the owner of the leasehold or working interest agrees to assign his interest in certain specific acreage to the assignees, retaining some interest such as an overriding royalty interest, an oil and gas

payment, offset acreage or other type of interest, subject to the drilling of one or more specific wells or other performance as a condition of the assignment.

1.3.12 "General and Administrative Overhead" means all customary and routine legal, accounting, geological, engineering, well supervision fee, travel, office rent, telephone, secretarial, salaries, and other incidental reasonable expenses necessary to the conduct of the program, and generated by the sponsor.

1.3.13 "Non-Capital Expenditures" means expenditures which are not considered as capital expenditures and as such are allowable as expenses in the current year pursuant to the provisions of the Income Tax Act (Canada).

1.3.14 "Operating Costs" means costs incurred in producing and marketing oil or gas from completed wells, including labour, fuel, repairs, hauling, materials, supplies, utility charges, ad valorem and severance taxes, insurance and casualty loss expense, and compensation to well operators or others for services rendered in conducting such operations.

1.3.15 "Organization and Offering Expenses" means all costs of organizing and selling the offering, including underwriting and brokerage commissions and all customary fees and expenses of issue as may be negotiated for the program's account with the underwriter or selling agent.

1.3.16 "Overriding Royalty Interest" means an interest acquired or withheld in the oil and gas produced (or the proceeds from the sale of such oil and gas) to be received free and clear of all costs of development, operation, or maintenance and, for the purpose of this policy, includes a mineral owner's royalty interest reserved at the time of the creation of an oil and gas lease.

1.3.17 "Participant" means an investor in an oil and gas program.

1.3.18 "Production Program" (sometimes known as an Income Program) means a program where not less then 90% of the proceeds of issue (after offering expenses including selling commissions) will be spent in the acquisition of producing wells or proved producing reserves for which there are firm contracts for the commencement of production, and where not more than 10% of the proceeds of issue (after offering expenses including selling commissions) may be spent, directly or indirectly, in the drilling of development wells and/or exploratory wells.

1.3.19 "Program" or "oil and gas program" means a partnership or other form of business

entity formed to explore for, develop or produce oil and gas.

1.3.20 "Prospect" means a geographic or stratigraphic area in which the program owns or intends to own one or more oil and gas interests, which is geographically defined on the basis of geological data by the sponsor of the program and which is reasonably anticipated by the sponsor to contain at least one reservoir or part of a reservoir of oil and gas.

1.3.21 "Sponsor" means the promoter or any person or company who manages or participates in management of a program. The term includes the general partner of a limited partnership and any other person or company who, pursuant to a contract, regularly performs (or selects the person or company who performs) 25% or more of the program's activities, and also includes any associate or affiliate of the sponsor.

1.3.22 "Subordinated Interest" means a net carried interest whereby the holder is not required to participate in exploration and development costs of a property but is entitled to a share of its net revenues (i.e. after operating costs, royalties, and general administrative overhead) only after the exploration and development costs of the property have been fully recovered from its net revenues by those persons and companies who financed them.

1.3.23 "Subscription Commitment" means the amount agreed by a participant to be contributed to a program at the time of his original subscription for securities of a program.

1.3.24 "Working Interest" means an interest in the net revenues of an oil and gas property which is proportionate to the share of exploration and development costs borne until such costs have been recovered, and which participates in some share of net revenues thereafter.

2. DISTRIBUTION SPREAD (Item 1 of Form 14)

2.1 Selling commissions shall be payable in cash. Any other compensation, including finder's fees, shall be disclosed and if not paid or payable in cash may be paid in units of the program if valued at the offering price to the public; payment of such expenses by way of an overriding royalty or other interest in property is not acceptable (refer also to item 7.4.1 of this policy).

2.2 A firm price to the public is required.

2.3 For a drilling program, the minimum investment shall not be less than 1 unit and not less than $5,000, and the initial cash payment shall not be less $2,500.

2.4 For a production program, the minimum investment shall not be less than unit and not less than $2,500, and the initial cash payment shall not be than $1,000.

2.5 Initial cash payments must be paid within 90 days from the date of issue of the receipt for the prospectus or such longer period as the Director may allow.

2.6 Disposition of units must be limited so that a participant holds not less than 1 unit except by gift or by operation of law.

3. PLAN OF DISTRIBUTION (Item 2 of Form 14)

3.1 In the absence of a firm underwriting, warrants or options to dealers will not be permitted. A single underwriting option of 10% or less of the units underwritten may be permitted if at a price not less than the net offering price of the underwritten units and if exercisable within 45 days of the date of issue of the receipt for the prospectus by the Registrar.

3.2 Arrangements for deferred payments for units may be allowed when warranted but such arrangements shall be subject to the following conditions:

3.2.1 The dates of deferred payments shall coincide with the anticipated cash needs of the program, but the full amount of the purchase price shall be paid within a reasonable time not exceeding two years from the date of issue of the receipt for the prospectus by the Registrar.

3.2.2 The program shall not sell or assign the arrangements for deferred payment, except that this requirement shall not apply to assignments under Section 177 of the Bank Act.

3.3 In the event of default in the payment of any deferred payment when due, the participant's percentage interest in the program shall not be subject to forfeiture but may be subject to a reasonable reduction for failure to meet his commitment. Reduction provisions in respect of default in payment of assessments will be considered reasonable if they conform to the reduction provisions provided in item 8. 10 relating to defaults of assessments.

4. USE OF PROCEEDS (Item 5 of Form 14)

4.1 Where the issue is sold on a best efforts basis, a minimum as well as a maximum size of offering shall be stipulated. The minimum shall provide sufficient funds for the stated

minimum objectives of the program and receipt of subscriptions (and the required minimum initial cash payments thereon) aggregating the minimum size shall be a prerequisite to activation of the program. In any offering by way of a limited partnership the filing of a "notice to amend a certificate" (see item 5. 1) shall be a prerequisite to the activation of the program.

4.2 An offering for less than $500,000 net to the program, after payment of all organization and offering expenses (see item 7.4.1) shall be considered inadequate for the spreading of risk and shall be unacceptable.

4.3 Subscriptions received prior to activation of the program must be deposited intact with an independent custodian registered under The Trust Companies Act (Alberta), and the custodian's name and address shall be disclosed in the prospectus. Subscription funds shall be released by the custodian to the issuer of the securities only after subscriptions aggregating the minimum size of the offering (and the required minimum initial cash payments thereon) have been deposited with the custodian within a time acceptable to the Director (which time will ordinarily be 90 days or such extension thereof as the Director, upon request, may permit). Provision must be made for the return of 100% of subscriptions to subscribers in the event the minimum sum is not received by the custodian within the stipulated time.

4.4 If, in the opinion of the Director, the sponsor of the program has limited successful experience in oil and gas programs or the oil and gas industry, the Director may require all or part of the subscriptions received to be held by a custodian under item 4.2 pending arrangements for the acquisition of suitable properties, and the provision of an acceptable amendment to the prospectus to all purchasers of the securities.

4.5 Until proceeds from the public offering are invested in the program's operations, they may be temporarily invested in short-term highly liquid investments where there is a safety of principal, such as securities of, or guaranteed by, the Government of Canada or any Canadian province, or certificates of deposit or interest-bearing accounts of Canadian chartered banks or trust companies registered under The Trust Companies Act (Alberta).

4.6 Subscriptions unexpended 2 ½ years from date of issue of the receipt for the prospectus by the Registrar shall be returned pro-rata to the public subscribers.

4.7 If purchase of specific properties is contemplated, the Commission is to be supplied under section 88 of the Regulations with the report of an independent engineer supporting the value of the reserves or property to be acquired. The report and disclosure shall include dollar valuation of cash flow of oil and gas reserves to be acquired on both an

undiscounted basis and discounted at rates which conform to the requirements of National Policy No. 2-B.

4.8 A sponsor may be reimbursed out of subscriptions and program revenues for all actual and necessary expenses of the program, including an allocable portion of the sponsor's general and administrative overhead determined in accordance with generally accepted accounting principles. Overhead costs must be justifiable as to need for the services and the reasonableness of amount charged.

4.9 In describing the use which will be made of unallocated funds, the "Use of Proceeds" section of the prospectus shall disclose, in tabular form and in reasonable detail, an estimate of expenses to be charged to the program showing separately:

4.9.1 expected direct expenses, and

4.9.2 general and administrative overhead broken down by types of services and costs with a separate breakdown of salaries to officers, directors and other principals of the sponsor. A summary of the manner in which such overhead expenses are allocated shall be included. The sponsor shall bear a share thereof proportionate to its share of revenue from the time that participation commences and the prospectus shall show, in tabular form:

4.9.2.1 the dollar amount of such allocation charged to each program promoted by the sponsor in the last three years,

4.9.2.2 the amount of such allocation expressed as a percentage of subscriptions received by each such program, and

4.9.2.3 the maximum amount of overhead per annum to be charged to the program while subscriptions are being expended, with a statement that any excess amount per annum will be absorbed by the sponsor.

4.10 The prospectus shall describe how funds and title to properties shall be held.

4.10.1 Funds of a program must not be commingled with funds of any other entity; the prospectus must clearly prohibit any such commingling. Except as specified by the standard form of contract of the Canadian Association of Petroleum Landmen, 1981 edition, advance payments to the sponsor should be prohibited, except where necessary to secure tax benefits of prepaid drilling costs. Advance payments should not include non-refundable payments for completion costs prior

to a decision being made that the well warrants a completion attempt.

4.10.2 Program properties may be held in the names of nominees temporarily to facilitate acquisition of properties and for similar valid purposes. On a permanent basis, program properties may be held under a declaration of trust in those situations where recognized industry practice is to hold such interests in trust, provided that the Director may in his discretion require that the properties be held in the name of a special nominee partnership organized by the general partner solely for the purpose of holding of record of title for properties, provided that such nominee engages in no other business and incurs no other liabilities.

5. NAME AND INCORPORATION OF ISSUER (Item 8 of Form 14)

5.1 Many offerings take the form of Alberta limited partnerships. The Commission requires that a limited partnership be in formal existence on or before the date of issue of a receipt for the prospectus; this requirement win necessitate the filing in Central Registry of Alberta of the certificate required by the Partnership Act (Alberta), signed by the general partner and at least one limited partner (who is not a member of the public). The certificate, or a draft, must be supplied to the Commission with the preliminary prospectus. The preliminary prospectus and prospectus shall each give appropriate disclosure. Final material supplied to the Commission shall include evidence that

5.1.1 the limited partnership has been formed, and

5.1.2 the limited partnership certificate specifically empowers the general partner to admit additional limited partners to the partnership.

5.2 When distribution has been completed, the Commission is to be supplied with evidence that a "Notice to Amend a Certificate" has been filed with respect to the additional limited partners.

6. DESCRIPTION OF BUSINESS AND PROPERTY OF ISSUER (Item 9 of Form 14)

6.1 The face page shall prominently disclose whether the program is a drilling program or production program, and in making disclosure for Item 9(a), the nature of the intended business shall be clearly and succinctly described in an opening paragraph. This paragraph shall include matters such as the intended type of operation (for example the purchase of producing wells, development drilling of proven or probable reserves, exploratory drilling, or any combination of these), the scale of operation (for example single property programs or diversified packages, in each case of known properties or future acquisitions) and the

method of operation (whether the sponsor expects to be the operator of the program, or whether the sponsor will act simply as a money manager by farming out prospects to others).

6.2 If the sponsor intends to convert or exchange the units (at a future date) into shares of the sponsor or some other entity, this intent shall be disclosed on the face page and referenced to the page where full details of the conversion or exchange are set forth.

6.3 The body of the prospectus shall describe in reasonable detail the investment objectives and policies of the program and indicate whether they may be changed by the general partner without a vote of the limited partners and, if and to the extent that the sponsor is able to do so, the approximate percentage of assets which the program may invest in any one type of investment. The prospectus shall state the approximate percentage of exploratory and development drilling to be done by the program, the method of acquisition of leases, including information as to committed farm-outs, and the approximate percentage of development drilling to be done through acquisition of offsetting leases as opposed to development of drilling sites acquired in the exploratory state. State also the expected percentage of leases where the program will not have control of drilling and operation.

6.4 Where proceeds from the offering are to be expended on drilling, disclose the total incentive drilling credits to be earned and the extent to which they will be received by the program.

6.5 The Commission expects that substantially all drilling programs will set forth the speculative warning required by Item 10; besides referring to promotional interest in properties granted to sponsors and to specific risk factors, the speculative warning shall also refer to the lack of any market for resale of units and disclose that the investment is primarily suitable only to those persons in higher income tax brackets. Investors should be advised in one or more carefully organized, concise sentences, with bold print phrases and subcaptions where appropriate, of the risks to be considered before making an investment in the program. A face page warning shall be cross-referenced to that part of the prospectus disclosing risk factors in greater detail.

6.6 The prospectus shall disclose the location and describe the general character of all material oil and gas interests held and, where purchase of specific reserves are contemplated, of properties intended to be acquired by the program (including appropriate operating data) in the manner required by Item 9(c). Where the prospectus refers to oil and gas reserves, use of rates for discounted cash flow and the criteria used in computing the value of reserves shall conform to the requirements of National Policy No. 2-B.

6.7 In giving information on production or drilling results over the last five years as called for in Item 9(c), (vi) and (vii), the Director may permit or require that such information be given of the sponsor's operations, and/or other programs operated by the sponsor. Where information of the performance on previous programs is to be given,

6.7.1 the previous program experience of the sponsor and other relevant parties shall be disclosed in the prospectus for all programs during the past 5 years which

6.7.1.1 were offered by prospectus, or

6.7.1.2 were offered pursuant to prospectus exemptions,

the results of which are material to an informed investment decision by the investor.

6.7.2 information on previous programs shall include, but need not be limited to, the following:

6.7.2.1 name of program, including type of legal entity and place of incorporation or organization,

6.7.2.2 effective date of each offering, date it commenced operations and date of dissolution or termination, or a statement that it is continuing,

6.7.2.3 total number of units, gross amount of capital raised by the program, number of participants, and (if applicable) amount of investment by the sponsor,

6.7.2.4 drilling results of program, including number of gross and net wells drilled, both oil and gas, both exploratory and development, and both successful and unsuccessful,

6.7.2.5 for previous Canadian offerings, total dollar amount per unit and type of tax deductible items passed on to investors,

6.7.2.6 income credited and cash distributed to investors and to spon sor,

6.7.2.7 compensation and fees to sponsor segregated as to type, and

6.7.2.8 such additional or different disclosures of the success or failure of the programs as may be permitted or required by the Director.

6.7.3 the information required in item 6.7.2 shall be set forth on a cumulative basis for each program, and in tabular form wherever possible.

6.7.4 the following caveat should be prominently featured in the presentation of the foregoing information: "IT SHOULD NOT BE ASSUMED THAT PARTICIPANTS IN THE OFFERING MADE BY THIS PROSPECTUS WILL EXPERIENCE RESULTS, IF ANY, COMPARABLE TO THOSE EXPERIENCED BY INVESTORS IN PRIOR PROGRAMS".

7. PROMOTORS (Item 15 of Form 14)

7.1 *Requirements of sponsor*. The Commission considers it essential that resources available to drilling programs shall include an acceptable level of experience and financial competence on the part of the promoter and sponsor.

7.1.1 *Experience*

7.1.1.1 In a limited partnership, and by analogy in other forms of entity, the general partner or its chief operating officers shall have at least 3 years relevant oil and gas experience demonstrating the knowledge and experience to carry out the stated program policies and to manage the program operations. Additionally, the general partner or any associate or affiliate providing services to the program shall have not less than 4 years relevant experience in the kind of service being rendered or otherwise must demonstrate sufficient knowledge and experience to perform the services proposed. If any managerial responsibility for the program is to be rendered by persons or companies other than the general partner, such persons or companies must be identified in the prospectus, their experience must be similar to that required of a general partner and must be set out in the prospectus, and an acceptable contract setting forth the basis of their relationship with the program must be included under "Material Contracts" disclosure and supplied to the Commission.

7.1.2 *Net Worth of Sponsors*

7.1.2.1 The financial condition of sponsors must be commensurate with financial obligations assumed by them and audited balance sheets of sponsors shall be furnished to the Commission upon request. If a company is a sponsor, it will be sufficient that an unaudited balance sheet, prepared by the company's auditors, be furnished if it is accompanied by a comfort letter from the auditors and an audited balance sheet prepared to a date within the immediately preceding 12 months.

7.1.2.2 The general partner must specifically have a minimum aggregate net worth at all times equal to 5% of participants' capital in all existing programs organized by the general partner plus 5% of total subscriptions in the

program being offered, but such required minimum net worth shall not be less than $100,000 and need not exceed $1,000,000. The general partner shall undertake in the prospectus to maintain its net worth at not less than the minimum aggregate net worth calculated above and to file annually for the public files of the Commission its audited annual financial statements during the term of the program and for 6 years thereafter, and the partnership agreement shall so provide.

7.1.2.3 If an individual is a general partner, his net worth shall be determined exclusively of home, home furnishings and automobiles, and an unaudited balance sheet prepared by a Chartered Accountant and signed and sworn to by such individual general partner may, in the discretion of the Director, be accepted for the purpose of determining said required net worth.

7.1.2.4 In determining a sponsor's net worth, the discounted value of its net cash flow from proven and probable reserves of oil, gas and other minerals, as determined by an independent petroleum appraiser and at acceptable and stated current discount rates, may be used. Notes and accounts receivable from all programs, interests in all programs, and all contingent liabilities should be included in the net worth computation. If an individual sponsor's net worth is used in complying with the above requirements, a statement as to such net worth shall be included in the prospectus.

7.1.2.5 If more than one person or company acts or serves as general partner, the net worth requirements may be met by aggregating the net worth of all such persons or companies. Also, the net worth of any guarantor of the general partner's obligations to or for the program may be included in the net worth computation, but only if the guarantor's liability is coextensive with that of the general partner.

7.2 In complying with the disclosure requirements of Item 15(a), the prospectus shall include details of all benefits, direct and indirect, to be received by the sponsors. Besides compensation in the form of monetary benefits, disclosure shall include ownership, use and availability of seismic and other geological information obtained by the program and disclosure of any interest in property or share of drilling credits and production revenues of the program retained by the sponsor. The foregoing should also be summarised together, under a separate heading, in tabular form.

7.3 *Remuneration of Sponsor*

7.3.1 The Act provides that the Director shall direct the Registrar not to issue a receipt in any of the circumstances set forth in section 96, including the payment of an

unconscionable consideration for promotional purposes or the acquisition of property. The Commission recognizes that rewards to the sponsor of a program may take several forms, and that the need for knowledge, expertise and services by management, and the ability or willingness of the sponsor to supply them, may vary greatly between one type of promotion and another.

7.3.2 In general terms, the variety and complexity of services rendered and compensation received by the sponsor make it necessary for each offering to be reviewed upon its individual merits. Where it seems that the total compensation is an unjustified enrichment of the sponsor at the expense of the investors, a receipt will not be issued. Also in general terms, the Commission favours arrangements which reward successful operations and discourages arrangements such as flat fees or overriding commissions which reward without skill, risk, or results.

7.4 *Guidelines for Certain Expenses*

7.4.1 *Organization and Offering Expenses*

7.4.1.1 It is expected that selling commissions will reflect the quality and risk of the offering, and that the promoter will recover the reasonable costs of organization, including the expenses of issue, as a first charge against the proceeds of issue. The Commission is of the opinion that the aggregate of commissions, organization and offering expenses of this nature in a typical offering will not exceed 15% of gross subscriptions received, according to the circumstances of the offering, including the willingness of the payee to accept payment out of the first proceeds of production.

7.4.2 *Administration and Management Expenses*

7.4.2.1 Arrangements by the sponsor for recovery out of subscriptions or revenue of actual and necessary direct costs and (where appropriate) an equitable portion of the cost of general, administrative, and management overhead (see item 4.8) will be acceptable provided that a maximum charge expressed either as a fixed dollar amount or as a fixed percentage of total funds expended, is specified and is commensurate with necessary services to be provided. The arrangements shall be formalized by contract (which shall be summarized in the prospectus) and shall be subject to annual audit by the program's auditors. The sponsor's percentage share of direct costs and of overhead attributable to the program shall be not less than its percentage entitlement to the revenues of the program at that time.

7.4.3 *Field and Operating Expenses*

7.4.3.1 Arrangements by the sponsor for recovery out of subscriptions or revenue of the actual and necessary direct field costs and field overhead of exploration, development, and oil and gas well operation and maintenance will be acceptable, where such services are to be provided by an independent third party. Such costs will also be acceptable where the sponsor will be the operator of the program provided that

7.4.3.1.1 a contract in the standard form of the Canadian Association of Petroleum Landmen is entered into,

7.4.3.1.2 the contract terms are negotiated at arms-length by the several parties having an interest in the prospect, and

7.4.3.1.3 the program and the sponsor in aggregate do not have a controlling interest in the property.

7.4.3.2 Where the sponsor is the operator but the above criteria will not apply, the sponsor must substantiate that adequate safeguards exist against conflict of interest and duplication of cost of services.

7.4.3.3 The sponsor's percentage or share of direct field costs and field overhead shall not be less than its percentage entitlement to the revenue, if any, from that program at that time.

7.5 *Guidelines of Promotional Interest*

7.5.1 It is anticipated that most sponsors will obtain their profit by means of a carried promotional interest in program properties. Such promotional interest, in general terms, would be a carried interest to point at which production is obtained by the program. When the sponsor becomes entitled to a share of production under his promotional interest, he shall bear operating costs in the same ratio as he participates in program revenues. In this way the sponsor of a successful program will benefit significantly, whereas thesponsor of a "dry hole" program will obtain little compensation other than return of the actual cost of the initial expenses of issue. In a successful program the Commission is of the opinion that investors are entitled to a return of their initial outlay before a sponsor can materially share in the revenues obtained from a successful prospect on the basis of his promotional interest.

7.5.2 Accordingly, the Commission will look for arrangements which provide for a promotional interest which is subordinated to payout from net operating revenues of all costs required to drill a well and place it on production. Where pre-production costs are shared between the sponsor and

participants on a functional allocation basis (for example where depreciable costs for tax purposes are for the account of the sponsor and expenses which need not be capitalized for tax purposes are primarily for the account of participants) it will not be considered unreasonable if the sponsor is entitled to recover its well cornpletion costs in priority to participants.

7.6 *Sponsor's Additional Earned Working Interest in Program*

7.6.1 The sponsor's working interest may be increased in additional increments of 5% for each additional 5% increase in the percentage of capital contribution paid by it up to a maximum of 75% of revenues, including the promotional interest. Such additional increments shall be committed at the commencement of the program and shall be paid according to the same payment schedule as is applied to the participants. Net production revenues for a prospect shall be computed in accordance with generally accepted accounting principles and shall include, inter alia, all costs of operating the leases underlying the prospect and an appropriately allocated portion of all other program expenses, including organizational and offering expenses.

7.7 *Functional Allocation of Costs*

7.7.1 Where the sponsor shares in capital contributions of a program a typical arrangement is a division of costs between the sponsor and participants on a functional allocation basis, so that capital expenditures (i.e. depreciable costs) are for the account of the sponsor and all other pre-production expenditures (i.e. those that may be written off immediately for tax purposes) are primarily for the account of participants. Capital expenditures are ordinarily required towards the end of a drilling operation by which time it may be evident that revenue from production will be sufficient to recover part, but not all, of the total cost to bring the well into production; in such cases a sponsor is inevitably faced with a conflict between his own interests and those of participants. The Commission will accept reasonable arrangements whereby the sponsor's share of capital expenditures on a prospect receive priority of payout over other pre-production expenditures. The prospectus shall disclose and explain the need for such arrangements.

7.7.2 For the avoidance of doubt,

7.7.2.1 where there is a functional allocation of costs the sponsor will be required to assume all capital expenditures with a known minimum percentage of total expenditures. Accordingly, if capital expenditures comprise a smaller percentage of total expenditures than the stated percentage, the sponsor will be required to assume a portion of other pre-production expenditures

to make up the difference. If capital expenditures exceed the percentage, the excess will be for the account of the sponsor as one of those entrepreneurial risks for which a promotional interest is awarded.

7.7.2.2 The above arrangement to pay capital expenditures refers to and includes all capital expenditures for the drilling and completing of wells during the life of the program, but does not include capital expenditures for facilities downstream of a wellhead. If the sponsor enters into farm-out or other arrangements whereby it is relieved of its obligations to pay for such capital expenditures, then the sponsor's share of revenue shall be proportionately reduced.

7.7.2.3 The sponsor must have a net worth of $300,000 or 10% of the participants' total contributions to the program whichever is greater, and must be under a contractual obligation to pay its share of expenses.

7.8 *Non-Arms Length Property Transactions*

For the purposes of disclosure required by Item 15(b) regarding the sale of assets by the promoter to the program, and by Item 15(a) regarding other matters and non-arms length transactions between the promoter and the program, the criteria in items 7.9 and 7.10 must be followed.

7.9 *Sales and Purchases of Properties*

7.9.1 Such transactions must be consistent with the objectives of the program. The sponsor of a program shall not sell, transfer or convey any property to or purchase any property from the program, directly or indirectly, except on a fair and reasonable basis to the participants of the program. In the case of a sale, transfer or conveyance to or from a program,

7.9.1.1 the prospectus must disclose that the sponsor will sell, transfer or convey property to the program and whether the property will be sold from the sponsor's existing inventory.

7.9.1.2 the purchase from or sale to the program must be at cost as adjusted for intervening operations, unless the sponsor has reasonable grounds to believe that cost is materially more than or less than the fair market value of such property, in which case such purchase or sale shall be made for a price not in excess of its fair market value, as determined by an independent petroleum and natural gas engineer.

7.9.1.3 if the sponsor sells, transfers or conveys any oil, gas or other mineral

interests or property to a drilling program, it must concurrently sell to the program an equal proportionate interest in all its other property in an area of mutual interest.

7.9.1.4 if the sponsor subsequently proposes to acquire an interest in a prospect in which the program possesses an interest or in a prospect abandoned by the program within 3 years preceding such proposed acquisition, the sponsor shall offer such interest to the program and, if cash or financing is not available to the program to enable it to purchase such property, the sponsor shall not acquire such interest or property. The term "abandon" for the purpose of items 7.9.1.4 and 7.10.2 shall mean the termination, either voluntarily or by operation of the lease or otherwise, of all of the program's interest in the prospect. The provisions of item 7.9.1.4 shall not apply after the lapse of 5 years from the date of formation of the program. For the purpose of item 7.9.1.4, the term "sponsor" shall not include another program where the sponsor's interest is identical to, or less than, its interest in the subject program.

7.9.1.5 a sale, transfer or conveyance to a program of less than all of the sponsor's ownership in any interest or property is prohibited unless the interest retained by the sponsor is a proportionate working interest, the respective obligations of the sponsor and the program are substantially the same after the sale of the sponsor's interest, and its interest in revenues does not exceed the amount proportionate to its retained working interest. The sponsor may not retain overrides or other burdens on the interest conveyed to the program and may not enter into farm-out arrangements with respect to its retained interest, except to non-affiliated third parties or other programs managed by the sponsor.

7.9.1.6 the sponsor (other than public programs) shall not purchase producing property from a drilling program.

7.9.1.7 a production program shall not purchase properties from nor sell properties to any program in which its sponsor has an interest. This item 7.9.1.7 shall not apply to transactions among programs having the same sponsor by which property is transferred from one to another in exchange for the transferee's obligation to conduct drilling activities on such property (or to joint ventures among such programs) provided that the respective obligations and revenue sharing of all parties to the transactions are substantially the same, and provided further that the compensation arrangement or any other interest or right of the sponsor is the same in each program, or, if different, the aggregate compensation of the sponsor does not exceed the aggregate compensation it would otherwise have

received from the programs.

7.10 *Restricted and Prohibited Transactions*

7.10.1 The sponsor (excluding another program in which the sponsor is a general partner) shall not enter into any farm-out or other agreement with the program where, in consideration for services to be rendered, an interest in production is payable to such sponsor.

7.10.2 During the existence of a program and before it ceases operations, the sponsor (excluding another program where the interest of the sponsor is identical to or less than its interest in the subject program) shall not acquire, retain, or drill for its own account any oil and gas interest on any prospect upon which such program possesses an interest, except for sales or lease transactions which comply with item 7.9.1.5. In the event the program abandons (as defined in item 7.9.1.4) its interest in the prospect, this restriction shall continue until 3 years following the abandonment. If the geological limits of a prospect are enlarged to encompass any interest held by such sponsor (excluding another program where the interest of the sponsor is identical to or less than its interest in the subject program), such interest shall be sold to such program in accordance with the provisions of items 7.9.1.3 and 7.9.1.4 and any net income previously received by the sponsor shall be paid to such program. If within this period, the sponsor acquires additional acreage or interest in a prospect of the program, the sponsor must sell it to the program and is prohibited from retaining any such interest, except as may be permitted by item 7.9.

7.10.3 The sponsor shall not take any action with respect to the assets or property of the program which does not benefit primarily the program, including among other things:

7.10.3.1 the utilization funds of the program as compensating balances for its own benefit, and

7.10.3.2 further commitments of production.

7.10.4 All benefits from marketing or other arrangements affecting property of the sponsor and the program shall be fairly and equitably apportioned according to the respective interest of each.

7.10.5 Any agreements or arrangements which bind the program must be fully disclosed in the prospectus.

7.10.6 Anything to the contrary notwithstanding, a sponsor may never profit by drilling in contravention of his fiduciary obligation to the participants.

7.10.7 The sponsor shall not render to the program any oil field, equipage or drilling services nor sell or lease to the program any equipment or related supplies unless

7.10.7.1 it is engaged, independently of the program and as an ordinary and ongoing part of its business, in the business of rendering such services or selling or leasing such equipment and supplies to a substantial extent to others in the oil and gas industry in addition to programs in which it has an interest.

7.10.7.2 the compensation, price or rental therefor is competitive with the compensation, price or rental of others in the area engaged in the business of rendering comparable services or selling or leasing comparable equipment and supplies which could reasonably be made available to the program.

7.10.7.3 if it is not engaged in a business within the meaning of item 7.10.7.1, such compensation, price or rental shall be the cost of such services, equipment or supplies to it or the competitive rate which could be obtained in the area, whichever is less.

7.10.8 All services for which the sponsor receives compensation shall be embodied in a written contract which precisely describes the services to be rendered and all compensation to be paid.

7.10.9 No loans may be made by the program to the sponsor.

7.10.10 On loans made available to the program by the sponsor, the sponsor may not receive interest in excess of its interest costs, nor may the sponsor receive interest in excess of the amounts which would be charged the program (without reference to the sponsor's financial abilities or guarantees) by unrelated banks on comparable loans for the same purpose and the sponsor shall not receive points or other financing charges or fees regardless of the amount.

8. ISSUANCE OF UNITS (Item 19 of Form 14)

8.1 *Undertakings*

8.1.1 The Commission requires an undertaking from a limited partnership and its general partners to hold an annual meeting and to comply with Part 11 of the Act, and with Part 12 insofar as it is appropriate to a limited partnership.

8.2 *Disclosure of Special Attributes*

8.2.1 The units of a limited partnership have some rights and obligations not expected

by investors whose previous investment experience was limited to the attributes of companies' shares. Those matters which are material from an investment viewpoint must be clearly disclosed in addition to disclosure required by Item 19.

8.3 *Loss of Limited Liability*

8.3.1 Disclosure must be made that a limited partner may lose the protection of limited liability in certain circumstances such as, for example, by participating in management of the limited partnership or for loss to a third party as a result of false statements in the partnership certificate. Disclosure shall also be made that there is a potential for unlimited liability to the extent that the principles of Canadian law recognizing the limitation of liability of limited partners have not been authoritatively established with respect to limited partnerships formed under the laws of one province but operating, owning property, or incurring obligations in another province.

8.4 *Partners' Access to Information*

8.4.1 A partner is ordinarily entitled to greater detailed information and access to records than would be expected by a shareholder of a company in similar circumstances. The comments in item 8.5 are not intended to be exhaustive.

8.5 The general partner shall maintain a list of the names and addresses of all participants at the principal office of the partnership. Subject to the safeguards embodied in Uniform Act Policy 2-06, such list shall be made available for the review of any participant or his representative at reasonable times and, upon request either in person or by mail, the general partner shall furnish a copy of such list to any participant or his representative for the cost of reproduction and mailing.

8.6 Participants and/or their accredited representatives shall be permitted access to all records of the program, after adequate notice, at any reasonable time. The sponsor shall maintain and preserve during the term of the program and for 6 years thereafter all accounts, books, -and other relevant program documents. Notwithstanding the foregoing, the sponsor may keep logs, well reports and other drilling data confidential for as long as the value of the information to the partnership as a whole depends upon its confidentiality.

8.7 The partnership agreement shall provide for transmittal to each participant of an annual report and interim reports in compliance with the requirements of the Act and Regulations for corporate issuers. The following additional information shall accompany such annual reports:

8.7.1 A summary itemization, by type and/or classification, of total fees and compensation including overhead reimbursements paid by the program, or

indirectly on behalf of the program, to the sponsor. If compensation is paid on a subordinated interest, a reconciliation shall be made of all such payments to the conditions precedent and limitations thereto.

8.7.2 A description of each prospect in which the program owns an interest , but succeeding reports need contain only material changes, if any, regarding such prospects.

8.7.3 A list of wells drilled by the program (indicating whether each well has or has not been completed), and a statement of the cost of each well completed or abandoned. Justification shall be included for wells abandoned after production has commenced.

8.7.4 For a program which compensates the sponsor on a basis related to certain costs paid by the sponsor, a schedule showing

8.7.4.1 total program costs and, where applicable, the costs pertaining to each prospect, the costs paid by the sponsor and the costs paid by the participants,

8.7.4.2 total program revenues, the revenues received by or credited to the sponsor and the revenues received by or credited to the participants, and

8.7.4.3 a reconciliation of such costs and revenues to the limitations prescribed.

8.7.5 Annually, beginning with the fiscal year succeeding the fiscal year in which the program commenced operations, an estimate of the total oil and gas proven and probable reserves of the program, the dollar value of the cash flow therefrom on both an undiscounted basis and discounted at rates which conform to the requirements of National Policy No. 2-B, and a computation of each participant's interest in such reserve value. The reserve computations shall be based upon engineering reports prepared by qualified independent petroleum consultants. An estimate of the time required for the extraction of such reserves shall also be provided with a statement that, because of the time period required to extract the reserves, the present value of cash flow to be obtained in the future is less than if immediately receivable. In addition, after the occurrence of an event leading to a reduction of the program's reserves of more than 10%, excluding reduction resulting from production, a computation and estimate shall be sent to each participant as soon as possible but not later than 90 days after the occurrence.

8.7.6 See item 9.4.3 for requirements of reporting upon farm-outs.

8.8 By March 31 of each year, the general partner must furnish a report to each participant

containing such information as is pertinent for tax purposes.

8.9 *Transferability of Limited Partners' Interests*

8.9.1 Any restriction on assignment of limited partners' units or the substitution of limited partners will be looked upon unfavourably and will be allowed only to the extent supported by opinion of counsel as to their legal necessity.

8.10 *Assessments and Defaults*

8.10.1 In appropriate cases there may be a provision for assessments. Assessments will be raised by way of an offering document similar in all material respects to material required of a company offering new shares to its shareholders under section 107(l)(h) of the Act. The offering material shall comply with A.S.C. Policy 5.2 and shall include with the call for assessment a statement of the purpose and intended use of the proceeds from the assessment, a statement of the penalty to be imposed on the participant for failure to meet the assessment and, to the extent practicable, a summary of pertinent geological data on the relevant properties to which the assessment relates.

8.10.2 A voluntary assessment shall not exceed 100% of the initial subscription.

8.10.3 A mandatory assessment shall not exceed 25% of the initial subscription.

8.10.4 Assessments shall be solely for the purpose of drilling, equipping or completing a development well (or wells) and/or for such processing, gathering and other facilities that are necessary in order to cause the hydrocarbons in the well(s) to be marketable, acquiring additional interest or leases related to a prospect already owned by the program, keeping title to reserves in good standing through payment of necessary taxes and land rentals, preserving the partnership's interest in the event of blow-outs, and reimbursing sponsors for any emergency payments made in respect of all or any of the above matters.

8.10.5 In the event of a default in payment of all or a portion of the assessment, the participant's percentage interest that has been already earned in the program represented by his unit should not be subject to forfeiture, but may be subject to a reasonable reduction. Provisions which conform to the following will be considered reasonable.

8.10.5.1 *Voluntary Assessments*

8.10.5.1.1 A permanent proportionate reduction of the participant's

percentage interest in revenues derived from future development based on the ratio of his unpaid assessment to all capital contributions used for such future development, or

8.10.5.1.2 A subordination of the defaulting participants right to receive revenues from future development until those non-defaulting participants who have paid the defaulting participant's assessment have received an amount of revenues from future development up to 300% of the proportionate amount of the defaulted assessment which they have paid.

8.10.5.2 *Mandatory Assessments*

8.10.5.2.1 A permanent proportionate reduction of the participant's percentage interest in all program revenues based on the ratio of his unpaid assessment to all capital contributions, or

8.10.5.2.2 A subordination of the defaulting participant's right to receive any program revenues until those nondefaulting participants who have paid the defaulting participant's assessment have received an amount of revenues from all revenues of the program up to 3000% of the proportionate amount of the defaulted assessment which they paid.

8.10.5.3 The alternatives set forth in items 8.10.5.1 and 8.10.5.2 are not exclusive and other provisions demonstrated to be essentially equivalent to these alternatives may be permitted by the Director.

8.11 *Cash Redemption Values*

8.11.1 When cash redemption values of units are computed, such values mus be clearly based on appraisal of properties by qualified independent petroleum consultants. Evaluations by company personnel must be based on such independent appraisals. Redemptions must be for cast and shall not be considered effective until cash payments have been paid to the participants.

8.12 *Meetings*

8.12.1 Meetings of participants may be called by the general partner(s), or by participants holding more than 10% of the then outstanding units for any matters for which the participants may vote as set forth in the limited partnership agreement or charter document. A call for a meeting shall be deemed to have been made upon receipt by the general partner of a written request from holders of the requisite percentage of units stating the purpose(s) of the meeting. The general partner shall deposit in the mails, within 15 days after receipt of said request, written notice of the meeting to all participants and the purpose of such meeting, which shall be held on a date not less than 30 nor more than 60 days after the date of mailing of said notice, at a reasonable time and place sufficient for the purposes of the meeting.

8.13 *Exchanges and Reinvestment*

8.13.1 No sponsor shall make or cause to be made an offer to a participant to purchase his units or to exchange his units for a security of any issuer, unless:

8.13.1.1 the offer is made after the expiration of 6 months after the completion of expenditure of subscriptions on the program or such shorter period of time as the Director may in his discretion permit,

8.13.1.2 the offer is made to all participants,

8.13.1.3 the offer, if made by a third party to the sponsor or principal underwriter, is on a basis not more advantageous to the sponsor or principal underwriter than to participants,

8.13.1.4 the net asset value of the security or other consideration offered is at least equivalent to the net asset value of the units,

8.13.1.5 in computing the exchange ratio the value of any reserves used is supported by a current appraisal prepared by an independent petroleum consultant; the value of any undeveloped acreage used is at cost unless fair market value, as evidenced by supporting data, is higher; and the value of other assets used is based on audited financial statements prepared in accordance with generally accepted accounting principles consistently applied or, &appropriate, is based on fair market value as determined by independent qualified appraisers,

8.13.1.6 the offer is made pursuant to all requirements under the Act.

8.13.2 For the purpose of item 8.13.1 an "offer to exchange" includes any security of a

program which is convertible into a security issued by the sponsor or another issuer.

8.13.3 An offering will be unacceptable to the Director if it includes a provision requiring participants to reinvest their share of distributable cash distributions. Subject to compliance with applicable securities laws, a program may make available to its participants a voluntary plan for systematic reinvestments in such program or in any other program. No sales commissions may be charged participants for effecting such reinvestment.

8. 14 *Distribution of Revenues*

8.14.1 From time to time and not less often than semi-annually, the sponsor will review the program's accounts to determine whether cash distributions are appropriate. The program will distribute pro-rata to the participants funds received by the program and allocated to their accounts which the sponsor deems unnecessary to retain in the program. The determination to make cash distributions and the percentage calculation thereof from the program to the sponsor will be made on the same basis.

9. OTHER MATERIAL (Item 32 of Form 14)

9.1 *Taxation*

9.1.1 So that prospective investors may accurately evaluate tax benefits which may personally accrue to them, it is essential that taxation disclosure be under a separate heading in the prospectus and be clear and explicit. Where more than one class of security are offered, the prospectus must explain the reasons for the different classes, of security and the taxation characteristics of each class.

9.1.2 The opening remarks under taxation disclosure shall

9.1.2.1 identify the person taking responsibility for the taxation disclosure in the prospectus, and

9.1.2.2 include a bold print warning that

9.1.2.2.1 tax considerations ordinarily make the securities offered more suitable for those having a high taxable income;

9.1.2.2.2 regardless of any taxation benefits which may be obtained, a decision to purchase the securities offered should be based primarily on an appraisal of the merits of the investment, as such, and on an investor's ability to

bear possible loss;

9.1.2.2.3 those acquiring the securities with a view to obtaining tax advantages should consult a tax adviser who is knowledgeable in this field.

9.1.3 The prospectus shall state simply

9.1.3.1 the advantages to be obtained by the investor in the current taxation year;

9.1.3.2 the continuing taxation benefits to be obtained by the investor in future taxation years;

9.1.3.3 the taxation implications, upon disposal of the securities

9.1.3.3.1 to the investor, and

9.1.3.3.2 to the new owner.

9.1.4 The timing and method shall be disclosed by which the investor will be informed of data which may be, or is to be, included in the investor's personal income tax return.

9.1.5 Where both Canadian exploration expenses and Canadian development expenses are to be incurred, disclosure must include a table showing the estimated proportion of investors' funds to be expended upon each category; where the proceeds of the offering will be expended over two or more taxation years, the table must show the estimate for each category of expense for each taxation year and disclosure must contain a bold print warning that the table of expenditures, both as to type and timing, are considered by management to be reasonable estimates only, and may be subject to modification and change.

9.1.6 Where taxation disclosure is stated to be based upon the opinion of a named tax expert, the consent of that expert must be supplied to the Commission. The Commission may require evidence that an advance income tax ruling has been obtained from the Department of National Revenue, Taxation.

9.2 *Duration of Partnership*

9.2.1 A limited partnership agreement shall state that no partner has the right to demand return of his capital contribution except pursuant to dissolution of the partnership, but this shall not prevent express provision for any partner from applying for

redemption of his units as envisaged in item 8.11 and being paid in cash, subject to the liquid resources available to the partnership.

9.2.2 A limited partnership agreement shall provide that upon cancellation of the Limited Partnership Agreement the partnership shall be dissolved forthwith and its remaining assets, if any, sold at fair market value and the proceeds distributed forthwith to those entitled to them.

9.3 *Liability and Indemnification*

9.3.1 The Commission wishes to ensure that the general partner and the other sponsors shall, in performing their duties, exercise the degree of care, the diligence and skill that a reasonably prudent manager and operator of petroleum and natural gas properties would exercise in similar circumstances and that the general partner and the sponsors shall discharge their duties honestly, in good faith, and in the best interests of the partnership and the investors.

In particular, the Commission wishes to ensure that the partnership ought not to indemnify the general partner or any other sponsors where they have not met the standards of care which it believes are in the public interest.

9.4 *Farm-Outs*

9.4.1 *Definition*

9.4.1.1 The prospectus shall contain the definition of farm-out which appears in item 1.3.11; no other term shall be used to describe a farm-out transaction.

9.4.2 *Disclosure*

9.4.2.1 The prospectus shall state the circumstances under which the sponsor may farm-out a prospect or lease, the ability to farm-out to other public programs of the sponsor, and any limitations on the ability to farm-out to such public programs.

9.4.2.2 The prospectus shall state that the sponsor (except other programs of the sponsor) shall not enter into any farm-out or other agreement with the program where, in consideration for services to be rendered, an interest in production is payable to such sponsor in addition to the promotional interest earned.

9.4.2.3 The prospectus shall state that program leases will not be farmed-out, sold, or otherwise disposed of unless the sponsor, exercising the standard

of a prudent operator, determines

9.4.2.3.1 the program lacks sufficient funds to drill on the leases and cannot obtain suitable alternative financing for such drilling,

9.4.2.3.2 the leases have been downgraded by events occurring after assignment to the program to the point that drilling would no longer be desirable to the program, or

9.4.2.3.3 drilling on the leases would result in an excessive concentration of program funds in one location creating in the opinion of the sponsor undue risk to the program.

9.4.2.4 In any event, where program leases are farmed-out, sold or otherwise disposed of, the program will retain such economic interests and concessions as a reasonable prudent operator would retain under the circumstances.

9.4.3 *Reporting*

9.4.3.1 The annual and interim reports shall contain a description of all farm-outs including sponsors' jurisdiction, location, time, farmee, and general description of terms.

9.5 *Conflicts of Interest*

In addition to any disclosure which may be relevant under Item 29 (Interest of Management and Others in Material Transactions) or item 7.8, disclosure shall be made, under an appropriate heading, of potential areas of conflict of interest including, for example, a statement

9.5.1 that the decision for making a farm-out and the terms of a farm-out to a program involve conflicts of interest, as the sponsor may benefit from cost savings and reduction of risk, and in the event of a farm-out to an affiliated public program, the sponsor will represent both partnerships.

9.5.2 regarding farm-outs from a drilling or production program to another such program meeting the requirements of item 7.9.1.7.

9.5.3 that except as required by item 7.9.1.3, the program shall acquire only those leases reasonably acquired for the stated purpose of the program and no leases shall be acquired for the purpose of subsequent sale or farm-out, unless the acquisition of such leases by the program is made after a well has been drilled to a depth sufficient to indicate that such acquisition is believed to be in the best interests of

the program.

9.5.4 that the sponsor shall not farm-out a lease for the primary purpose of avoiding payment of sponsor's costs relating to drilling a lease or prospect.

9.5.5 that where there is a functional allocation of costs and certain well completion expenses are the sole responsibility of the sponsor, there may occur in some circumstances a conflict between the limited and general partners as to the desirability of completing sub-economic wells.

9.5.6 describing fully any types of transactions which may be entered into between the program and the sponsor. If known or proposed, include a full description of the material terms of any agreement (and the dollar amount thereof) between the program and the sponsor. If the sponsor originates or promotes other programs, describe the equitable principles which will apply in resolving any conflict between the programs. If the program has been in existence, describe all material transactions and contracts of the program with the sponsor during the period of such existence.

9.5.7 disclosing whether the sponsor has been in the chain of title or had a beneficial interest within the past 5 years in any property to be acquired by the program.

9.6 *Financial Information on Sponsors*

9.6.1 Pursuant to item 7.1.2 the Commission may permit or require, as material disclosure, inclusion of financial information on the general partner of a partnership (or program operator of another form of program) to be included in the prospectus. Such disclosure may consist of full audited financial statements as would be required by the Act had the general partner been the issuer of the securities being offered, or such lesser disclosure as may in all of the circumstances seem sufficient to the Director for the protection and information of investors.

Effective date: March 15, 1987