



NOA To Be or Not To Be Effective on This Day!

THERE HAS BEEN MUCH DEBATE AND DEBACLE OVER THE YEARS RELATED TO ACCOUNTING ADJUSTMENTS for the period between the Transfer Date and the Binding Date of a Notice of Assignment (NOA).

There are two schools of thought:

1. On and after the Binding Date, the Assignee becomes the recognized party to the Master Agreement with respect to any and all matter or thing occurring or accruing beyond the Transfer Date, which by definition means "the effective date of the transfer of the Assigned Interest". Very important to note that it is not defined as the date of the transfer (in other words the closing date); but, instead, that date the transfer was made effective (sometimes also called an adjustment date).
2. Alternatively, the Transfer Date has no application to the Third Party. All matter or thing

which accrued prior to the Binding Date is for the Assignor's account and any adjustments related to the period between the Transfer Date and Binding Date are to be settled between the Assignor and Assignee. After all, Clause 8 of the Notice of Assignment states "... In addition, Assignor and Assignee agree that they shall be solely responsible for any adjustment between themselves with respect to the Assigned Interest as to revenues, benefits, costs, obligations or indemnities which accrue prior to the Binding Date" – but wait, this will be addressed below!

The Act of Novation

It is of fundamental importance that everyone remembers that a NOA is not a standalone document and that its use, application, and effect are dictated by the Assignment Procedure. It is equally important to remember that the NOA is

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a contractual instrument instituted by Industry in substitution for the assignment and novation agreement (A&N), but which still results in novation. This means, "the act of those concerned parties agreeing that their mutual agreement has been replaced by a new one among differing parties." In the case of a NOA, this occurs as of the Transfer Date when the old party is discharged from, and the new party assumes all, the rights and obligations of the old party under the Agreement as provided by Clause 3.01 of the Assignment Procedure.

What is the Binding Date

To determine which, if either, of the two above approaches is correct, let's first determine exactly, "what is the Binding Date"? By definition under the Assignment Procedure, it means "the first day of the second calendar month following the month in which the Notice of Assignment is served". Quite simply, it is an administrative trigger date at which time the NOA becomes effective against the Third Party. In other words, the act of novation is deemed to have occurred as of the Binding Date. But, remember, the act of novation occurring on the Binding Date is different than the date the Third Party is deemed to have agreed that the novation (substitution of the parties) is effective; being the Transfer Date. The Binding Date of a NOA is no different than the date that all counterpart pages had been signed and distributed to the parties to an A&N. This is where all the third parties recognize the Assignee as the correct party to that agreement from and after the effective date stipulated in the A&N.

Things You Should Know About the Transfer Date

Before beginning to address the effect of the NOA on the Third Party there are a few other things to be considered by the Assignor and Assignee. The first issue is establishing the Transfer Date to be stated in the NOA as the effective date or adjustment date versus the closing date of the transaction, when risk, possession and title are actually transferred, assigned and conveyed:

- Purely from a legal and contractual perspective, the effective or adjustment date is the date the parties have agreed to

adjust revenues and expenses (and occasionally risk) back to the date the cash or bona fide value to be given to the Assignor for the Assigned Interest at closing was determined. Use of the effective or adjustment date as the Transfer Date is not a big deal for revenues and expenses. However, the subsequent effect of Clause 3.01 on the Third Party is to have the Assignee responsible for any of the interim period liability (e.g. – court action, taxes, facility fire) from the effective or adjustment date forward, not the closing date forward. Notwithstanding that Clause 3.02 of the CAPL Property Transfer Procedure deems "benefits, obligations and risks" back to the Effective Date, this may not always be the agreed upon arrangement in a different form of purchase and sale agreement between an Assignor and Assignee.

- To the contrary, based on the "matching principle" of accrual accounting, where one tries to match costs and expenses to the associated revenues and periods of time, it is logical and practical to link the cash flow (revenues-expenses) to the incremental risk associated with the generation of that cash flow. It is helpful to use the Effective or Adjustment Date as the Transfer Date in the NOA, for the following reasons:

- the Assignee would have likely had the opportunity to conduct due diligence and conditionally walk away from closing the transaction (e.g. "no substantial damage" condition) if they were not prepared to take the Assigned Interest on an "as is" basis;
- the maintenance of business provisions in a purchase and sale agreement typically provide the Assignee with influence over operations during the interim period;
- this date is usually linked to a production month vs. a closing date that is other than the 1st day of a given month and avoids odd adjustments;
- it mitigates rework on documents when the closing date changes even a day (a very common occurrence);
- it encourages shorter interim periods due to the operational risks;



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- the Canada Revenue Agency's tax requirements can be managed through a tax adjustment provision; and
- the CRA is not requiring tax adjustments and allowing the purchaser to include sale proceeds in its income where the effective date and closing date are in the same calendar month).

Industry seems to understand and accept that risk, possession and title doesn't actually pass until the closing date pursuant to most purchase and sale agreements. However, everyone seems to be using the effective or adjustment date as the Transfer Date in their NOA, with respect to the joint account held with the Third Party if there is an unusual event requiring a risk adjustment, the indemnification and subordinate auxiliary conveyance document provisions of a typical purchase and sale agreement would likely cause this to become a vendor – purchaser action, regardless of which party the Third Party may hold liable under the Agreement.

What Happens Pursuant to the Assignment Procedure

The Assignment Procedure provides as follows:

- Clause 2.05 says, "An assignment of an Assigned Interest shall... be effective against Third Party on the Binding Date".
- Clause 3.01 states that following the Binding Date "the Assignor has transferred, assigned and conveyed... to Assignee as of the Transfer Date"
- Assignee shall replace Assignor as a party to the Agreement "on and after the Transfer Date;"
- As far as a Third Party is concerned, (i) "Assignee shall assume and be bound by, observe and perform all terms, obligations and provisions in the Agreement... [and] shall assume and be entitled to all rights, benefits and privileges under the Agreement... on or after the Transfer Date, and (ii) Assignor shall retain and be entitled to all rights, benefits and privileges under the Agreement... prior to the Transfer Date;"
- Third Party... [and] Assignee... "(i) releases and discharges Assignor from the observance and performance of all terms and covenants... and all obligations and liabilities which arise or occur on or after the Transfer Date under the Agreement; and (ii) does not release and discharge Assignor from any obligation or liability which had arisen or accrued prior to the Transfer Date;"
- In all matters relating to the Assigned Interest "subsequent to the Transfer Date and prior to the Binding Date," Assignor acts as trustee for and duly authorized agent of Assignee; and
- The Agreement "shall continue in full force and effect from and after the Transfer Date with Assignee made a party thereto... subject to Clause 3.01(d), being that above provision for the Assignor to have acted as trustee for the Assignee."

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- Clause 3.03 says, "Assignor and Assignee shall be solely responsible for any adjustments between themselves with respect to the Assigned Interest as to revenues, benefits, costs, obligations or indemnities which accrue prior to the Binding Date".

So, now let's take a look at the situation from two very different points in time – prior to and subsequent to the Binding Date.

Pre-Binding Date (Novation Has Not Occurred)

Until novation occurs on the Binding Date, the Assignor remains the recognized party to the Agreement and has the right and duty to act as trustee and duly authorized agent of the Assignee for all matters relating to the Assigned Interest subsequent to the Transfer Date and prior to the Binding Date.

It is not a reasonable expectation that once revenues, costs, and expenses are booked as actuals or accruals to a JIB account for any given accounting month prior to the Binding Date. This would cause Third Party accounting groups to go back and reverse any payments or charges to the Assignor related to the accounting months between the Transfer Date and the Binding Date.

Therefore, pursuant to Clause 3.03, the Assignor and Assignee are responsible to account for any adjustments between themselves for any revenues, benefits, costs, obligations or indemnities attributable to the Assigned Interest after the Transfer Date which are for the Assignee's benefit and which were accrued

to the Assignor's joint interest billing (JIB) account prior to the Binding Date.

Post-Binding Date (Novation Has Occurred)

The Binding Date has no application or relevance after it passes – it was simply the trigger date at which time the act of novation occurs and become binding on all the parties. The Assignee is now the recognized party to the Agreement in all matters pertaining to the Assigned Interest from the Transfer Date onwards. The trustee, agency, and adjustment provision in Clauses 3.01(d) and 3.03 took care of the interim period issues as between the Assignee and Assignor. At this point in time, the Assignor has been released and discharged from, and the Assignee has assumed all the obligations, liabilities, rights, benefits, and privileges under the Agreement on and after the Transfer Date. The Assignor no longer has the ability to act as the trustee and duly authorized agent of the Assignee.

Accounting for actual revenue payments is often several months behind the production accruals. It is not a reasonable expectation for the Assignor to continue to receive JIB's well beyond the Binding Date for production months occurring several months in advance of the Binding Date and relating to revenues, costs and expenses accruing on and after the Transfer Date. The Third Party has been deemed to have already agreed that these accruals belong to the Assignee by virtue of the act of



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novation. This practice further complicates the final settlement of accounts between the Assignor and Assignee commonly occurring 180 days after closing in most purchase and sale agreements.

So, what about Clause 8 of the Notice of Assignment? Although this clause fails to reference the Transfer Date, it cannot be read and interpreted independent of the Assignment Procedure. The beginning of Clause 8 actually reads, "This Notice of Assignment shall become binding on all parties to the Master Agreement on the... (Binding Date)". Taken in context with the Assignment Procedure and novation, the later part of this clause, which says, "In addition, Assignor and Assignee agree that they shall be solely responsible for any adjustment between themselves with respect to the Assigned Interest as to revenues, benefits, costs, obligations or indemnities which accrue prior to the Binding Date", can be reasonably interpreted as intending to only apply to that Pre-Binding Date period, before novation occurred, when the Third Party was not required to recognize the Assignee.

Novation By Example

Using an example in which the NOA has a Binding Date of September 1 and a Transfer Date of April 1, the following accounting practice would apply:

For the accounting months preceding the September 1 Binding Date, the Third Party continues to deal with the Assignor, and the Assignor and Assignee make the applicable adjustments between themselves.

On the Binding Date, novation occurs, and Third Party deals directly with the Assignee for all matters accruing to the Assigned Interest for any and all production months after the April 1 Transfer Date.

For any rights, benefits, liabilities or obligation accruing to the Assigned Interest prior to the Transfer Date, the Third Party is to deal directly with the Assignor.

In summary, the Binding Date is only that date on which the Third Party must change its records to reflect the new party to the agreement effective as of the Transfer Date. The 1st School of Thought is the practice dictated by the Assignment Procedure and the legal act of novation and should be accepted and followed by Industry. It is also important to remember that, subsequent to the Binding Date, it is all about determining when the rights, benefits, liabilities, or obligation accrued under the Agreement, not when the accounting is done. To illustrate, an error discovered for the January-March period that is discovered in October should be sent to the Assignor, not the Assignee, as the issue is one that pertains to the period prior to the Transfer Date. ■

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