

**ANNUAL INFORMATION FORM FOR THE YEAR ENDED  
DECEMBER 31, 2010**

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**Dated March 31, 2011**

<b>DEFINITIONS, ABBREVIATIONS AND CONVERSIONS.....</b>	<b>4</b>
DEFINITIONS.....	4
ABBREVIATIONS.....	5
CONVERSIONS.....	5
FORWARD-LOOKING STATEMENTS.....	6
<b>CORPORATE STRUCTURE OF CALVALLEY PETROLEUM INC.....</b>	<b>6</b>
NAME, ADDRESS AND INCORPORATION.....	6
INTERCORPORATE RELATIONSHIPS.....	7
<b>GENERAL DEVELOPMENT OF THE BUSINESS.....</b>	<b>7</b>
THREE YEAR HISTORY.....	7
2008.....	7
2009.....	8
2010.....	8
<i>Recent Developments</i> .....	9
<b>DESCRIPTION OF THE BUSINESS.....</b>	<b>10</b>
GENERAL.....	10
THE BLOCK 9 PRODUCTION SHARING AGREEMENT.....	12
THE JOINT OPERATING AGREEMENT AND PARTICIPATION AGREEMENT IN RESPECT OF BLOCK 9.....	12
THE ETHIOPIAN PRODUCTION SHARING CONTRACT.....	13
MARKETING ARRANGEMENTS.....	13
FUTURE COMMITMENTS.....	14
EMPLOYEES, CONSULTANTS AND CONTRACTORS.....	14
CANADIAN OIL & GAS PROPERTIES.....	14
LEGISLATION AND REGULATIONS.....	14
ROYALTIES AND INCENTIVES.....	14
ENVIRONMENTAL REGULATION.....	15
<b>RISK FACTORS.....</b>	<b>15</b>
COMMODITY RISK.....	16
CHANGES IN LEGISLATION.....	16
RESERVE ESTIMATES.....	16
RESERVE ADDITIONS.....	16
CREDIT RISK AND CONCENTRATION OF SALES RISK.....	16
CONCENTRATION OF PRODUCING ASSETS.....	17
EXPLORATION, DEVELOPMENT AND PRODUCTION RISKS.....	17
LACK OF ADDITIONAL FINANCING.....	18
COMPETITION.....	18
POLITICAL RISKS.....	18
INSURABLE RISK.....	18
ENVIRONMENTAL, HEALTH, SAFETY AND REGULATORY APPROVALS.....	18
INTEREST RATES.....	19
CURRENCY FLUCTUATIONS.....	19
<b>DIVIDENDS.....</b>	<b>19</b>
<b>DESCRIPTION OF CAPITAL STRUCTURE.....</b>	<b>19</b>
GENERAL.....	19
<b>MARKET FOR SECURITIES.....</b>	<b>20</b>
<b>DIRECTORS AND OFFICERS.....</b>	<b>21</b>
GENERAL.....	21

2010 SHAREHOLDINGS OF THE BOARD .....	23
COMMITTEES OF THE BOARD.....	23
<i>Audit Committee</i> .....	23
<i>Auditors</i> .....	24
<i>Compensation Committee</i> .....	25
<i>Reserves Committee</i> .....	25
<i>Disclosure Committee</i> .....	26
<i>Corporate Governance Committee</i> .....	26
CEASE TRADING ORDERS, BANKRUPTCIES, PENALTIES OR SANCTIONS .....	26
CONFLICTS OF INTEREST .....	26
<b>LEGAL PROCEEDINGS.....</b>	<b>27</b>
<b>INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS .....</b>	<b>27</b>
<b>TRANSFER AGENTS AND REGISTRARS.....</b>	<b>28</b>
<b>MATERIAL CONTRACTS .....</b>	<b>28</b>
<b>INTERESTS OF EXPERTS.....</b>	<b>28</b>
<b>ADDITIONAL INFORMATION .....</b>	<b>28</b>
<b>SCHEDULE A-1: FORM 51-101F1.....</b>	<b>29</b>
<b>SCHEDULE A-2: FORM 51-101F2.....</b>	<b>46</b>
<b>SCHEDULE A-3: FORM 51-101F3.....</b>	<b>48</b>
<b>SCHEDULE B: AUDIT COMMITTEE MANDATE .....</b>	<b>50</b>
<b>SCHEDULE C: BOARD OF DIRECTORS MANDATE.....</b>	<b>54</b>

## DEFINITIONS, ABBREVIATIONS AND CONVERSIONS

References to “dollars” and “\$” set forth in this AIF are to the currency of the United States unless otherwise indicated and words importing the singular number only shall include plural and vice versa and words importing the masculine gender shall include the feminine and neutral gender and vice versa.

### Definitions

In this AIF, the capitalized terms set forth below have the following meanings:

“**AIF**” means this Annual Information Form dated March 31, 2011 of Calvalley Petroleum Inc. for the year ended December 31, 2010.

“**Block 9**” means a 2,234 square kilometre parcel of land located in the Shabwah/Hadramut region of central Yemen.

“**Board**” means the board of directors of Calvalley.

“**Calvalley**” or “**Company**” means Calvalley Petroleum Inc.

“**Calvalley Cyprus**” means Calvalley Petroleum (Cyprus) Ltd., a wholly owned subsidiary of Calvalley.

“**Cangulf**” means Cangulf Exploration Inc., a wholly owned subsidiary of Calvalley.

“**CBCA**” means the *Canada Business Corporations Act*.

“**Common Shares**” means the Class “A” common voting shares in the capital of the Company.

“**C\$**” means Canadian dollars.

“**HoodOil**” means HoodOil Ltd.

“**HoodOil Agreement**” means the agreement dated October 29, 2001 between Calvalley and HoodOil.

“**JOA**” means the joint operating agreement dated November 1, 2001 among Calvalley Cyprus, HoodOil and Yemen Co., as amended by the joint operating agreement dated January 8, 2002 among Calvalley, HoodOil, Yemen Co. and Reliance.

“**Ministry**” means the Ministry of Oil and Minerals of the Government of Yemen.

“**Participation Agreement**” means the participation agreement dated January 8, 2002 among Calvalley Cyprus, HoodOil and Reliance.

“**PSA**” means the production sharing agreement dated February 23, 1997, as amended, among the Ministry of Oil and Mineral Resources of Yemen, as it then was, Calvalley, and Yemen Co.

“**PSC**” means the production sharing contract dated October 16, 2008 between the government of the Federal Democratic Republic of Ethiopia and Calvalley.

“**Reliance**” means Reliance Industries Limited.

“**Safer**” means the Safer Exploration and Production Operations Co.

“**Transportation Agreements**” means all agreements with the Ministry and Minerals and the operator of Block 14 and 51 to transport blended crude from Block 9 through Block 51 to the Masila System (Block 14) for export.

“**TSX**” means the Toronto Stock Exchange.

“**Yemen**” means the Republic of Yemen.

“**Yemen Co.**” means a subsidiary of the Yemen Oil and Gas General Corporation organized and existing under the laws of Yemen.

#### Abbreviations

**In this AIF, the abbreviations set forth below have the following meanings:**

“**bbl**” means barrel, each barrel representing 34.972 Imperial gallons or 42 U.S. gallons.

“**bopd**” means barrels of oil per day.

#### Conversions

The following table sets forth certain standard conversions between Standard Imperial Units and the International System of Units (or metric units).

<b>To Convert From</b>	<b>To</b>	<b>Multiply By</b>
cubic feet	cubic meters	0.028
cubic metres	cubic feet	35.301
Bbls	cubic meters	0.159
cubic metres	Bbls	6.290
Feet	Meters	0.305
Metres	Feet	3.281
Miles	Kilometres	1.609
Kilometres	Miles	0.621
Acres	Hectares	0.4047

At year-end, Canadian dollar amounts for monetary assets and monetary liabilities were converted at the year-end exchange rate of \$1.0001 US dollars per Canadian dollar.

### Forward-Looking Statements

This AIF contains certain forward-looking statements. Some of the statements contained herein including, without limitation, financial and business prospects and financial outlooks of the Company may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will", "should", "could", "anticipate", "believe", "expect", "intend", "plan", "potential", "continue", and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic, political and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, management cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof.

Forward-looking statements and other information contained herein concerning the oil and gas industry and Calvalley's general expectations concerning this industry are based on estimates prepared by management using data from publicly available industry sources as well as from reserve reports, market research and industry analysis and on assumptions based on data and knowledge of this industry which Calvalley believes to be reasonable. However, this data is inherently imprecise, although generally indicative of relative market positions, market shares and performance characteristics. While Calvalley is not aware of any misstatements regarding any industry data presented herein, the industry involves risks and uncertainties and is subject to change based on various factors. See "Risk Factors."

Calvalley does not undertake any obligation to update publically or revise any forward-looking statements contained in this or in any other document filed with Canadian securities regulatory authorities, whether as a result of new information, future events or otherwise, except as required by applicable securities laws.

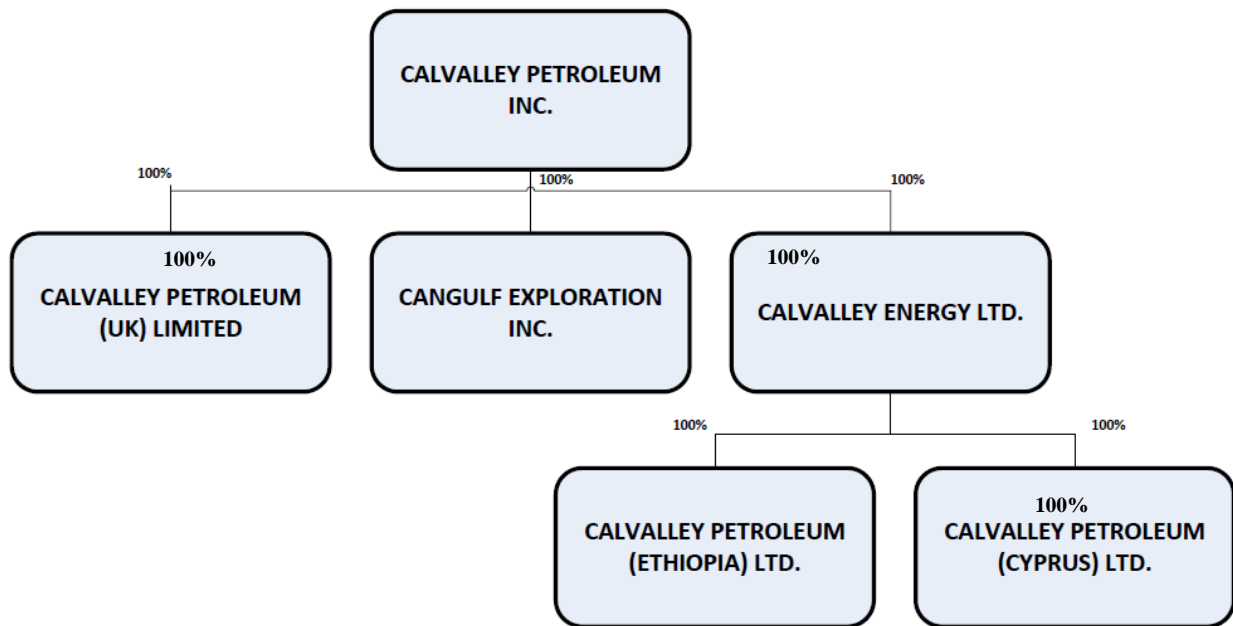
### **CORPORATE STRUCTURE OF CALVALLEY PETROLEUM INC.**

#### Name, Address and Incorporation

Calvalley is a corporation amalgamated under the CBCA. Calvalley has as its charter the Articles of Amalgamation dated July 1, 1996, as amended by Articles of Amendment dated July 24, 1996. The principal office of Calvalley is located at 700, 600 - 6<sup>th</sup> Avenue SW, Calgary, Alberta, T2P 0S5 and its registered office is located at 3700, 400 - 3<sup>rd</sup> Avenue SW, Calgary, Alberta, T2P 4H2.

Intercompany Relationships

Calvalley has three direct wholly-owned subsidiaries and two indirect wholly-owned subsidiaries. The direct wholly-owned subsidiaries are Cangulf Exploration Inc., a corporation incorporated under the laws of Barbados, Calvalley Energy Ltd., a corporation incorporated under the laws of Cyprus, and Calvalley Petroleum (UK) Limited, a corporation incorporated under the laws of the United Kingdom. The indirect wholly-owned subsidiaries, Calvalley Petroleum (Cyprus) Ltd. and Calvalley Petroleum (Ethiopia) Ltd., are both corporations incorporated under the laws of Cyprus and are direct wholly-owned subsidiaries of Calvalley Energy Ltd.



**GENERAL DEVELOPMENT OF THE BUSINESS**

Three Year History

2008

Production from the Hiswah field averaged a daily rate of 4,635 bopd. A key reservoir simulation study was conducted which was utilized to determine optimal development and injection well placement in order to optimize production from the Hiswah field. A deep exploratory well was drilled into the fractured basement at Qarn Qaymah (the “QQ-2”) which discovered hydrocarbons in the fractured basement and hydrocarbon potential in the Kohlan sands. Some formation damage occurred during the drilling of the well. The Company commenced operation of its central processing facility. The Company extended its marketing agreement with RIME until June 30, 2009.

During 2008, 440,000 stock options were exercised for proceeds of \$514,000. Additionally, the Company repurchased 1,604,896 shares on the open market under a normal course issuer bid for a total cost of \$4.8 million.

During 2008, the Company diversified its exploration portfolio by signing a Production Sharing Contract with the Ethiopian Government on the Metema and Gimbi blocks covering a total area of 11.5 million acres.

## 2009

Uncertainty in the global economic climate and the absence of an adequate arrangement to move all crude discovered on Block 9 caused delays in capital spending and, as a result, the drilling program for Block 9 was slower than originally planned. Management was reluctant to risk capital until signs of recovery began to emerge and the new transportation agreements were concluded. This slowdown in drilling activity expedited the resolution of the transportation agreements for all qualities of crude oil discovered within Block 9. Due to the complexity of the negotiations and the number of parties involved, these negotiations took a great deal of time and effort to finalize. The slowdown also allowed the Company to continue to high-grade its inventory of drilling locations. In 2009, Calvalley drilled three wells, including the Ras Nowmah exploration well and tested Qarn Qaymah.

Despite drilling only three wells (two development wells at Hiswah and one exploration well at Ras Nowmah) in 2009, Calvalley's proved plus probable reserves increased to 26.5 million bbls at December 31, 2009, representing an increase of nearly 8% (11% including reserves produced in 2009) over the 24.6 million bbls estimated by McDaniel and Associates at December 31, 2008. This represented a reserves replacement ratio of 343% on 2009 production. Cavalley's finding and development costs were \$4.68 per barrel on a three year average basis.

In response to the significant drop in average oil prices from 2008 to 2009, Calvalley exercised tight cost controls throughout the year and was thereby able to maintain a very healthy balance sheet, including Cash and GIC's of \$70.4 million and zero long-term debt entering 2010.

During 2009, 563,300 stock options were exercised for proceeds of \$776,000. Additionally, the Company repurchased 2,610,918 shares on the open market under a normal course issuer bid for a total cost of \$3.3 million.

## 2010

During the first quarter of 2010, Calvalley finalized its Transportation Agreements with the Ministry of Oil and Minerals ("MOM") and the Third Party Operator ("Third Party") to transport blended crude from Block 9 through Block 51 to the Masila System (Block 14) for export.

The Company drilled one exploration well, two appraisal wells and six development wells during 2010. As a result of the drilling activity and field optimization work at the Company's Hiswah field, the Company's proved and probable reserves increased to 31.8 million bbls at December 31, 2010, representing a 20% increase (23% including reserves produced in 2010) over the 26.5 million bbls at December 31, 2009. The Company's reserves replacement ratio is therefore 740% on 2010 production. The Company's finding and development costs for proved and probable reserves were \$0.64/bbl in 2010 and were \$2.55/bbl on a three year average basis.

During 2010, the Company also completed the majority of the work required to complete its truck offloading facility ("TOF") at Block 51. Upon completion of the TOF, the Company will have the capacity to produce and sell oil from all fields at Block 9 including the Al Roidhat and Ras Nowmah fields which are currently shut-in.

In addition, as a result of the success of the Ras Nowmah 2 well, the Company acquired approximately 340 km of 2D seismic data covering the Ras Nowmah and surrounding areas. The Company is currently interpreting the data and has identified a number of new leads and prospects. The Company began drilling a new exploration well in the East Ras Nowmah area in March 2011.

In Ethiopia, the Company completed the acquisition of aeromagnetic survey data covering the majority of the entire Metema Block (26,000 square kilometres). The survey coverage area is concentrated over the key area of the Mekele Sedimentary Basin highlighted by relatively thicker sedimentary rock sections based on our recently completed regional geological mapping.

#### Recent Developments

As Calvalley nears completion of the Truck Offloading Facilities ("TOF") at Block 51, the Company is entering an active phase of the development and appraisal drilling program to unlock the production and reserves potential of Block 9. As well, with the Company having established an improved export outlet, via the Masila Export Pipeline System ("MEPS"), the TOF will enable the Company to market its blend of better than 26° API crude at a price equivalent to the traditional Masila Blend.

In the longer term, the trucking will be replaced by an expandable capacity pipeline connecting Block 9 to the export line. Initial planning for construction of a pipeline to deliver blended oil from the Company's Central Processing Facility ("CPF") at Block 9 to the Masila system has commenced.

At the field level, Calvalley has positioned itself to gradually increase its production of blended crude to 10,000 bopd (5,000 bopd net). In that regard, the Company continues to add new development wells at its Hiswah, Ras Nowmah in preparation for the production increase. As well, the shut-in Al Roidhat wells are set to begin production which will be trucked for storage at the CPF until the TOF is commissioned. During Q4 2010, Calvalley successfully drilled a development well at the Al Roidhat field encountering 22 meters (72 feet) of net oil pay with average porosity of 23.5%. The well is now completed and is currently being production tested.

Drilling of the Qarn Qaymah-3 ("QQ-3") appraisal well was completed on March 8, 2011 to a total depth of 4,460 meters including an openhole section of approximately 1,000 meters in the Fractured Granitic Basement ("FGB"). The wellbore image logs and electrical logs indicate that the openhole section encountered a number of fractured sections in the FGB. On March 9, 2011, Calvalley began testing of QQ-3. The well is currently undergoing pressure build up. The testing program is expected to be completed in April 2011. Calvalley has retained the services of two well-known reservoir consulting firms in Calgary to analyze the well bore image logs and electrical logs in order to better define the reservoir.

Calvalley has recently commenced drilling of the Ras Nowmah East-1 ("RNE-1") exploration well. The well is targeting both Qishn and Saar Formation similar to those of the Ras Nowmah wells. The well is expected to reach total depth by mid-April 2011, at which time the drilling rig will be mobilized to the Ras Nowmah Field to drill two successive development wells (RN-4 and RN-5).

Major milestones are subject to risks noted under "Risk Factors". Milestones planned for 2011 include the following:

- Complete TOF at Block 51 ;
- Increase Block 9 gross production by activating shut-in wells;
- Continue to add new reserves and production through the development of existing discoveries and by drilling exploration, appraisal and development wells;
- High-grade the existing exploration portfolio of prospects and leads;
- Complete technical data acquisition in Ethiopia; and
- Utilize Calvalley's strong balance sheet and international operating experience by continuing to evaluate potential acquisitions of additional assets in the Middle East and Africa.

## **DESCRIPTION OF THE BUSINESS**

### **General**

Calvalley's principal business is oil and gas exploration, development, production and sale from its 50% working interest in Block 9 in Yemen, for which Calvalley serves as the operator (see "Description of the Business – The Joint Operating Agreement and Participation Agreement in Respect of Block 9"). The Company's operations, other than administrative functions undertaken at the Company's head office in Calgary, Alberta, are in Yemen, where it has established itself as a prudent and cost effective operator. Calvalley also holds a 100% working interest in a Production Sharing Contract with the Ethiopian Government for the exploration, development and production of petroleum substances in the Gimbi and Metema blocks. At present, substantially all of the operating assets of the Company are located in Yemen and Calvalley is economically dependent upon its foreign operations in Yemen.

Most of Calvalley's operations are focused on the development and production of its crude oil reserves from which all production is exported into highly competitive global markets for prices at or near Brent crude oil reference prices. Calvalley realized revenues of \$39.5 million, net of royalties, from sales of crude oil during 2010.

During the fourth quarter of 2008, Calvalley completed construction and commissioned the first phase of the permanent Central Processing Facility ("CPF") and gathering pipelines to improve efficiency and reduce operating costs. Currently, the Company trucks all of its crude oil production more than 250 kilometres to a receiving facility at Block 18, from which the crude oil is transported by pipeline to a marine terminal facility for export.

Calvalley directed significant effort during 2009 to concluding the Transportation Agreements that would enable the Company to commence production of its heavy oil. These agreements were finalized during the first quarter of 2010 and will enable

Calvalley to transport blended crude of 26° API or better to market through the Masila facility. Calvalley's crude will receive the Masila Blend price.

Through its ongoing development drilling program, Calvalley intends to increase the number of producing oil wells in its principal oil field at Hiswah as well as other oil and gas discoveries in the immediate vicinity of the CPF at Hiswah. During 2010, the Company also drilled development wells in the Al Roidhat field, from which any production will be trucked to the CPF for blending and processing. A blending facility has been constructed at the CPF to increase the quality of the heavy oil from the Al Roidhat field.

The Company tested the Ras Nowmah-2 discovery well during the third quarter of 2010. A number of tests were conducted with two different size pumps. The final test data were obtained utilizing a larger capacity downhole pump ("ESP") which was installed by the Company for this latest phase of testing operations. The well produced at a stabilized rate of approximately 3,000 bbl/d of sweet crude (approximately 30 degree API) and no formation water with only 9.5% pressure drawdown to the maximum operational capability of the ESP. Based on the pressure drawdown and build-up data, this 2nd phase of testing clearly indicates that the Ras Nowmah-2 well is potentially capable of producing at much higher flow rates. The test data were analyzed by an independent reservoir engineering firm in Calgary. The independent reservoir engineers calculated a flow rate in excess of 5,000bbl/d at a 20% pressure drawdown.

During 2010, Calvalley commenced Hiswah water injection at 6,500 barrels a day with a single horizontal well. The first water injection well (H-26) has been performing better than expected. The Company also commissioned the second water injector (H-25) and is monitoring the well performance. Up to five more water injectors are included in the 2011 drilling program. Two of these wells will be drilled in the first half of 2011. Management expects total water injection volume of more than 25,000 bbl/d by the end of 2011.

Starting with its most promising exploration opportunities, Calvalley intends to drill exploratory wells to confirm and expand the prospective production potential of Block 9. Calvalley intends to continue maintaining a prudent balance between exploration and development drilling activity.

There is significant competition for oil field services and supplies worldwide and Calvalley has established good working relationships with various suppliers in the Middle East in order to ensure that operational requirements do not experience undue operational or construction delays. Calvalley has a diversified procurement strategy to source a significant amount of oil field equipment from global suppliers to avoid being dependent solely on Middle Eastern suppliers.

### The Block 9 Production Sharing Agreement

The Company has the right to explore for and to produce oil and natural gas on the Malik Block concession (Block 9) in the Shabwah/Hadramut region of central Yemen. Those rights are defined under the PSA that was ratified by Presidential Decree No. 21 on April 3, 1997. Under the terms of the PSA, the fiscal arrangements between the Company and the Government of Yemen are established, as are the conditions and procedures to convert from the original "exploration period," as extended, into the current twenty year "development period" that started on June 10, 2005.

By mutual agreement between Calvalley and the Government of Yemen, the first exploration period under the PSA for Block 9 was extended during the third quarter of 1999 for a period of two years ending April 4, 2002. In early 2002, the Government of Yemen granted Calvalley an additional one year extension for the first exploration period to April 4, 2003. In 2003, the Government of Yemen granted Calvalley an additional one year extension for the first exploration period to April 4, 2004 which was subsequently extended to October 4, 2004. In October 2004, the Company entered into the second exploration period under the PSA, at which time Calvalley relinquished 25% of the original surface area of Block 9, thereby reducing its land holdings to 3,546 km<sup>2</sup> from the original 4,728 km<sup>2</sup> parcel.

In June 2005, the Government of Yemen approved the declaration of commerciality for Block 9, thereby concluding the second exploratory period and commencing the twenty year development period. Concurrently, the rights to a further 1,312 km<sup>2</sup> of land holdings were relinquished, reducing the remaining land holdings that will be retained by the Company to 2,234 km<sup>2</sup> until the term of the PSA expires.

### The Joint Operating Agreement and Participation Agreement in Respect of Block 9

In 2001 the Company entered into the HoodOil Agreement dated October 29, 2001 with HoodOil, an unrelated party, whereby the Company assigned 40% of its interest in the PSA to HoodOil. In exchange for this assignment, the Company received a letter of guarantee in the amount of \$10,000,000 in relation to the commitment by HoodOil to finance future exploratory costs under the PSA to a maximum amount of \$10,000,000 over both the first and second exploration periods. Pursuant to the terms of the HoodOil Agreement, Calvalley was entitled to an incentive fee of 50% of the amount by which the funds expended on the drilling program were less than the \$10,000,000 agreed cost.

As of November 1, 2001, the Company entered into the JOA in relation to the ongoing exploration and development under the PSA, whereby the Company was designated operator. In January 2002, the HoodOil Agreement relating to the PSA with the Government of Yemen was amended. Pursuant to the Participation Agreement, 50% of the 40% interest in the PSA was transferred from HoodOil to Reliance. On January 8, 2002, the terms and conditions of the JOA were also amended to take this into consideration and Reliance was added as a party to the JOA. In January of 2002, HoodOil and Reliance were also granted options to increase their respective interests by 5% each. In 2004, each of HoodOil and Reliance exercised their options to increase their respective interests by 5% for \$2,500,000 respectively. As at December 31, 2004, the Company retained a 50% working interest and operatorship of Block 9.

### The Ethiopian Production Sharing Contract

In 2008, Calvalley entered into its first Production Sharing Contract with the Ethiopian Government for the exploration, development and production of petroleum substances in the Gimbi and Metema blocks under a single contract covering a total area of over 46,470 km<sup>2</sup> (11.5 million acres).

Calvalley has a 100% operated working interest in both blocks for an exploration period of eight (8) years, consisting of an initial period of four (4) years followed by two (2) subsequent option periods consisting of two (2) years each. The option periods will be activated at the discretion of Calvalley. Furthermore, subject to hydrocarbon discovery during the total eight year period, the PSC provides for an additional twenty five (25) year development period with a ten (10) year optional extension. The PSC gives Calvalley the rights to explore, develop, and produce hydrocarbons including oil, condensate, and natural gas and associated liquids.

Total work obligations under the PSC, during the initial 4 year exploration program amount to approximately \$8.5 million and consist of the acquisition and processing of 400 km of 2D seismic and the drilling of one exploration well. The Company has incurred approximately \$1.2 million in respects of this commitment.

### Marketing Arrangements

In Yemen, producers of oil negotiate sales contracts directly with oil purchasers, at selling prices that are generally derived from benchmark crude oil reference prices such as Brent and West Texas Intermediate. Actual selling prices may vary from posted benchmark selling prices to reflect factors such as oil quality, prices of competing fuels, distance to market, the value of refined products and the supply/demand balance.

On January 16, 2007, Calvalley, along with its joint venture partners, entered into a long-term crude oil purchasing agreement with RIME, a company based in Dubai, United Arab Emirates and an affiliate of Reliance. The oil sales agreement contains “take or pay” provisions, which require RIME to purchase substantially all of the joint venture’s share of oil production from Block 9 during the term of the contract. The selling price under the contract is based on the official selling price (“OSP”) posted by the Government of Yemen less \$0.75 per barrel. The OSP is approximately equal to the Brent crude oil reference price. In April, 2009, the parties extended the agreement for 12 months with evergreen provisions in blocks of 12 months. The agreement remains in effect and can be terminated with 90 days notice.

In February 2010 Calvalley finalized Transportation Agreements to transport blended crude from Block 9 through Block 51 to the Masila System (Block 14) for export. The Transportation Agreements will enable Calvalley to transport blended crude of 26° API or better to market through the Masila facility. Calvalley will blend heavier crude oil from the currently shut-in Al Roidhat field with lighter oil produced from other fields within Block 9 to achieve the 26° API blend for shipment to Masila.

### Future Commitments

Calvalley has no hedging commitments or option contracts which were outstanding at December 31, 2008, December 31, 2009 or December 31, 2010.

### Employees, Consultants and Contractors

The Company possesses specialized skills and knowledge necessary to operate effectively in Yemen. The Company has operated in Yemen since 1997 and has developed significant operating expertise in this region. Calvalley's management has established an excellent working relationship with officials in the Ministry.

Calvalley uses the services of established contractors in connection with its drilling operations, facility and pipeline construction projects, trucking of oil production, well servicing and other operations.

With the onset of commercial production, Calvalley has increased its work force in order to properly staff crude oil production operations and infrastructure construction projects. Under the PSA, Calvalley is committed to actively promote indigenization of its work force in Yemen. While hiring a majority of Yemeni nationals in connection with its operations, the Company continues to hire expatriates and third country nationals in key positions.

Calvalley had 123 employees as of December 31, 2010 based in both Calgary and Yemen. Calvalley continues to hire both expatriate and local staff in an effort to expand its workforce within Canada and internationally.

### Canadian Oil & Gas Properties

Effective December 31, 2003, the Company disposed of its last operated Canadian oil and gas properties. The remaining Canadian properties are not material to the overall financial position and results of operations of the Company. In 2006 and 2007, 100% of the Company's remaining non-operated Canadian crude oil production was sold by the property operator at market prices. Calvalley no longer operates any oil properties in Canada.

### Legislation and Regulations

The oil and natural gas industry is subject to extensive controls and regulations imposed by various levels of government in jurisdictions which have oil and gas operations. Outlined below are some of the more significant aspects of legislation, regulations and agreements to which the Company must adhere. All current legislation is a matter of public record and the Company is unable to predict what, if any, additional legislation or amendments thereto may be enacted.

### Royalties and Incentives

In Yemen, the Company's royalties and taxes are determined based on the PSA. The share of crude oil production allocated to the Government of Yemen under the PSA is analogous to royalties in Canada's Western Canadian Sedimentary Basin and other hydrocarbon fiscal systems around the world. The Government of Yemen's share of

crude oil production includes a royalty on gross oil production, a share of profit oil (allocated after cost oil is taken by the Company) and an override on the Company's share of profit oil. The Company's share of profit oil is subject to income taxes (currently at the rate of 35%) which are paid out of the Government's share of profit oil noted above. The Company is obligated to pay production bonuses at the inception of commercial production and, in the future, when production rates increase (in increments of 25,000 bopd).

### Environmental Regulation

Globally, the oil and gas industry is subject to environmental regulation pursuant to local, provincial and federal legislation in each of the countries where oil and gas operations are active. In emerging nations, such as Yemen, where environmental regulations and legislation are evolving, many oil and gas exploration and production companies operate in accordance with standards prevailing in established oil and gas producing jurisdictions, such as Canada. Since Block 9 is predominately an arid desert area, the environmental impact associated with exploration and production activity is significantly less than is typical for production located in more temperate or tropical environments.

The Company is committed to conducting its operations in Yemen in accordance with environmental standards used by other major international oil and gas exploration and production companies. Generally, such standards meet or exceed those imposed by legislation and regulations in Yemen.

In most countries, environmental legislation includes restrictions and prohibitions on releases or emissions of various substances produced in association with certain oil and natural gas industry operations. Such legislation can affect the location and operation of wells and facilities and the extent to which exploration and development is permitted. In addition, typical legislation requires that well and facilities sites are abandoned and reclaimed to the satisfaction of regulatory authorities. A breach of such legislation may result in the imposition of fines or issuance of clean-up orders.

In many jurisdictions, new legislation, environmental standards and compliance for releases, site restoration and reporting are becoming stricter and more onerous. Also, the range of enforcement actions available and the severity of penalties have also been significantly increased. These trends may be followed in Yemen.

### RISK FACTORS

Calvalley is exposed to a number of risks inherent in exploring for, developing and producing oil and gas. This section describes the risks and other matters that would be most likely to influence an investor's decision to purchase securities of Calvalley.

Calvalley manages a number of risks in its business in order to achieve an acceptable level of risk without hindering the ability to maximize returns. Management has procedures to identify and manage significant operational and financial risks.

An investment in Calvalley should be considered speculative due to the nature of Calvalley's activities and the present stage of its development. Calvalley's operations are subject to all of the inherent risks normally associated with development and other operations conducted in respect of oil and natural gas properties as well as the inherent

risks attributable to companies dependent upon foreign operations, including the following which investors should carefully consider:

#### Commodity Risk

Calvalley's principal business is the production and sale of crude oil. Revenues, earnings and cash flows from the sale of crude oil are sensitive to change in market prices, over which the Company has little or no control. The Company has the ability to address its price-related exposures through the limited use of options, future and forward contracts, but generally does not enter into such arrangements.

#### Changes in Legislation

There can be no assurance that laws and regulations relating to the oil and gas industry will not be changed in a manner which would adversely affect the operations of the Company. Under the PSA, the Company is not obligated to comply with regulatory changes that are inconsistent with the provisions of the PSA. Further, the PSA stipulates that the interests, rights and obligations of the Government and the Company shall be solely governed by the provisions of the PSA unless altered or amended by mutual agreement. In particular, the PSA requires that the Government of Yemen pay profit taxes on the Company's behalf, out of the Government's share of profit oil.

#### Reserve Estimates

Proven and probable reserve estimates are determined based on professional evaluations provided by internal or external qualified persons. Reserve estimates should not be interpreted as assurances of the life or of the profitability of current or future operations. Estimates of the reserves may change based on additional knowledge gained subsequent to the assessment date. This may include additional data available from continuing exploration and development, results from the reconciliation of actual production data against the original reserve estimates, or the impact of economic factors such as changes in the price of commodities or the cost of components of production. The estimation of reserves is a subjective process, all of which are subject to numerous uncertainties and various interpretations.

#### Reserve Additions

Calvalley's future crude oil reserves and production, and therefore its operating cash flows and results of operations, are highly dependent upon the Company's success in exploiting its current reserve base and acquiring or discovering additional reserves. Without reserve additions through exploration, development or acquisitions, the Company's reserves and production will decline over time as reserves are produced. The business of exploring for, developing or acquiring reserves is capital intensive. To the extent cash flows from operations are insufficient and external sources of capital become limited or unavailable, Calvalley's ability to make the necessary capital investments to maintain and expand its oil and reserves will be impaired.

#### Credit Risk and Concentration of Sales Risk

As described in "Description of the Business – Marketing Arrangements," the Company entered into a long-term crude oil marketing agreement under which the Company will

sell all of its crude oil production to a single customer for a period of eighteen months. The customer is a subsidiary of Reliance Industries Limited, India's largest business enterprise, which is a party to the JOA and has guaranteed the customer's obligations under the crude oil marketing agreement. Reliance Industries Limited has been assigned credit ratings of Baa2 Stable Outlook by Moody's and BBB Stable Outlook by S&P (above Sovereign Rating). The current contract was formally extended in April 2009 and remains in effect.

Credit risk also relates to the risk that joint venture partners may not fulfill their contractual obligations for financial contributions towards the exploration, development, appraisal and production operations.

During the initial agreement negotiations and ratification, these risks are considered and incorporated into the terms of the contracts. Furthermore, cash calls can be made in advance of incurring costs to help ensure costs are recovered. However, it is possible that the interest of Calvalley and its joint venture partners are not aligned resulting in project delays, additional costs or disagreements, which could adversely affect business results.

#### Concentration of Producing Assets

Substantially all of Calvalley's production is generated from highly productive individual wells in Yemen. The production and sale of crude oil in Yemen involves the use of central production facilities, oil pipelines, and export terminals, either operated by the Company or by third parties. As significant production is generated from each of these assets, any single event causing an interruption to any one of these operations could result in the loss of production.

#### Exploration, Development and Production Risks

Acquiring, developing and exploring for oil and natural gas involves many risks. These include: encountering unexpected formations or pressures; premature declines of reservoirs; blow-outs, well bore collapse, equipment failures and other accidents; craterings and sour gas releases; uncontrollable flows of oil, natural gas or well fluids; and environmental risks.

In most oil and natural gas producing countries, oil and gas properties, together with related production and transportation infrastructure, are often situated in remote areas. In addition to the operational risks described above, oil and gas properties in these countries may be vulnerable to premeditated acts which have the potential to cause significant damage to oil and gas operations. The Company relies on the Government of Yemen's support in providing appropriate security for crude oil operations in Block 9.

Calvalley may not be fully insured against all of these risks. Losses resulting from the occurrence of these risks could have a material impact on the Company's financial results.

### Lack of Additional Financing

To the extent that external sources of capital become limited, unavailable or on terms not considered favorable to Calvalley, the Company's ability to make the necessary capital investments to maintain or expand its oil and gas reserves may be impaired.

### Competition

There is strong competition relating to all aspects of the oil and gas industry. Calvalley actively competes for skilled industry personnel, who are in high demand, particularly at its Canadian headquarters, with a substantial number of other oil and gas companies, many of which have significantly greater financial and other resources than Calvalley.

### Political Risks

Beyond the risk inherent in the oil and gas industry, the Company is subject to additional risks resulting from the current unrest in the Middle East. These risks can involve matters arising out of the evolving laws and policies, the imposition of special taxes or similar charges, oil export or pipeline restrictions, foreign currency controls, the unenforceability of contractual rights, restrictions on the use of expatriates in the operations and other matters.

There can be no assurance that agreements entered into with various parties are enforceable or binding in accordance with the Company's understanding of their terms or that if breached, the Company would be able to obtain favorable remedies. The Company bears the risk that political change could occur and that such change could have a further impact on the Company's operations.

### Insurable Risk

Calvalley employs risk management practices to reduce and mitigate operational risks and other hazard risks and exposures, although it is impossible to completely protect its operations from all such risks. The Company places types and an amount of insurance that it considers consistent with industry practice to the extent coverage is available and cost effective. Such coverage includes third-party liability insurance and property and business interruption insurance.

The Company may become liable for damages arising from unforeseen events which it cannot insure or chooses to self-insure. Costs incurred to repair such uninsured damage or to pay associated liabilities may have a material effect on the financial condition of the Company.

### Environmental, Health, Safety and Regulatory Approvals

Environmental, health and safety laws and regulations are continually evolving. Compliance with such laws and regulations can require significant expenditures which may materially affect the Company's financial condition or results of operations.

Expansion of existing operations and the development of new operating sites generally require approval of regulatory authorities. If such approvals are delayed or not achieved, the Company's ability to meet project schedule or cost objectives or to operate at expanded or existing levels could be materially impacted.

Workplace health and safety risks for workers arise from the inherent nature of the operations.

### Interest Rates

The Company has no interest-bearing debt. The Company invests surplus cash balances in GICs issued by an Alberta Credit Union guaranteed by the Province of Alberta. Fluctuations in interest rates, either favorable or unfavorable, which may have material effects on the Company's interest income on short-term cash investments.

### Currency Fluctuations

Calvalley undertakes transactions in currencies other than the United States dollar. The Company's primary foreign exchange risk is to changes in the value of the Canadian dollar relative to the United States dollar. Fluctuations in exchange rates between the United States dollar and other currencies will give rise to foreign currency exposure, either favorable or unfavorable, which may have material effects on the Company's operations and financial condition. The Company has the ability to address its currency related exposures through the use of foreign exchange contracts. It generally does not enter into such arrangements.

## **DIVIDENDS**

The Company has not declared or paid any dividends on any of its shares since incorporation. It is not expected that the Company will pay any dividends in the near future and Management expects that future earnings will be retained to finance further expansion of the business and operations of the Company. Any decision to pay dividends on any class of shares will be made by the Board on the basis of the Company's earnings, financial requirements and other conditions existing at such future time.

## **DESCRIPTION OF CAPITAL STRUCTURE**

### General

Calvalley is authorized to issue an unlimited number of Common Shares. These shares, in addition to having a voting right, are entitled to receive and to be paid, by the Company, in money, in shares or in property by the Company, out of the monies of the Company applicable to the declaration and the payment of dividends, any amount of declared dividend, if, as and when declared by the Board of the Company. Further, the holders of the Common Shares are entitled to receive the remaining assets of the Company upon its liquidation, dissolution, wind-up of the Company or any other distribution of its assets for the purpose of winding-up its affairs.

### MARKET FOR SECURITIES

Calvalley's Common Shares are listed for trading on the TSX under the symbol "CVI.A." The following table sets out the price range and trading volume of the Common Shares on a monthly basis for the year ending December 31, 2010, and for the months of January 2011 and February 2011, as reported by the TSX.

<b>Year</b>	<b>Month</b>	<b>High (\$)</b>	<b>Low (\$)</b>	<b>Volume</b>
<b>2010</b>	<b>January</b>	\$ 2.70	\$2.26	2,122,400
	<b>February</b>	\$ 2.64	\$2.08	1,946,300
	<b>March</b>	\$ 3.48	\$2.33	5,722,000
	<b>April</b>	\$ 4.20	\$3.20	3,392,100
	<b>May</b>	\$ 4.12	\$3.04	3,329,800
	<b>June</b>	\$ 3.45	\$ 3.13	738,000
	<b>July</b>	\$ 3.44	\$ 2.80	1,243,979
	<b>August</b>	\$ 3.82	\$ 2.84	2,026,859
	<b>September</b>	\$ 3.83	\$ 3.46	1,328,553
	<b>October</b>	\$ 4.09	\$ 3.22	1,524,321
	<b>November</b>	\$ 4.70	\$ 3.67	3,065,420
	<b>December</b>	\$ 5.05	\$ 4.36	949,585
<b>2011</b>	<b>January</b>	\$ 5.99	\$ 4.09	2,862,216
	<b>February</b>	\$ 4.88	\$ 3.75	3,796,923

## DIRECTORS AND OFFICERS

### General

As at December 31, 2010, the directors and senior executives of the Company, together with particulars related to them, are provided in the table below. The term of office for each director is from the date of the meeting at which he is elected until the following annual meeting or until his or her successor is elected or appointed.

Name, Address and Position or Office with Company	Principal Occupation During Last Five Years	Director or Senior Executive Officer Since	Number of Shares Beneficially Owned or Controlled
Edmund M. Shmoon (Chairman of the Board, Chief Executive Officer and Director) <i>Alberta, Canada</i>	Chief Executive Officer of the Company	October, 1989	470,400 <sup>(1)</sup>
Memet Kont (President, Chief Operating Officer and Director) <i>Alberta, Canada</i>	President and Chief Operating Officer of the Company,	April, 2008	121,700
Gary Robertson (Director) <i>Quebec, Canada</i>	President, Robertson Financial Services Inc.	June, 2004	300,000
Thomas H. Skupa (Director) <i>Alberta, Canada</i>	President, Cattom Enterprises Ltd.	June, 2005	54,714
Kenneth M. Stephenson (Director) <i>Alberta, Canada</i>	President, Kenaco Capital Services Inc.	May, 2006	200,500
Thomas E. Valentine (Director, Corporate Secretary) <i>Alberta, Canada</i>	Partner, Macleod Dixon LLP	May, 2006 (Director); November, 2004 (Corporate Secretary)	-
Zacharie J. Magnan C.A. (Acting Chief Financial Officer) <i>Alberta, Canada</i>	Vice-President Finance and Acting Chief Financial Officer, Finance Manager of the Company; Associate Partner, Hudson LLP	August, 2010	4,000

**Note: 1)** The only entity exercising beneficial ownership or control over more than 10% of the Common Shares of the Company is Calvalley Financial Inc. The voting shares of Calvalley Financial Inc. are held equally by Mr. Shmoon, Chairman of the Board and Chief Executive Officer of the Company, Deborah Shmoon, Mr. Shmoon's spouse, and the Shmoon Family Trust. As at December 31, 2010, Calvalley Financial Inc. beneficially owned 18,415,059 Common Shares, being 19% of the outstanding Common Shares. As at March 31, 2010, the beneficial ownership of Common Shares of the Company by Calvalley Financial Inc. remained the same, equating to 19% of the outstanding Common Shares of the Company.

**Edmund Shmoon**, was President, Chief Executive Officer and a director of O.R.I. Energy Inc., since its incorporation, and held a similar position with the predecessor

corporation to Calvalley Petroleum Inc. since 1995 and held the same positions with the Company until December 31, 1997. Since January 1, 1998, Mr. Shimon has held the positions of Chairman of the Board, Chief Executive Officer and President of the Company. He is also a director of Calvalley Petroleum (Cyprus) Ltd.

**Memet Kont** is a registered professional Engineer and professional Geologist with APEGGA and holds an MBA from the University of Calgary. Mr. Kont has developed strong technical and business skills through his positions at UBS Securities, Jennings Capital, McDaniel and Associates, and Geological Survey of Canada.

**Gary Robertson, C.A.**, is a chartered accountant by training. Mr. Robertson has worked for the past 25 years as President of Robertson Financial Services, where he has provided financial services in several areas. He has been particularly active in private equity formations, including a number in the oil and gas industry. Mr. Robertson is one of the original shareholders of Calvalley and its predecessor corporations and was also a Director of the Company from May 1994 to February 2000.

**Thomas H. Skupa** graduated, with a B.A.Sc. in Chemical Engineering from the University of British Columbia and an MBA from the University of Alberta. As president of Cattom Enterprises Ltd., Mr. Skupa currently provides business and project development services to the engineering, procurement and construction industries, specializing in oil & gas production, petroleum refining and petrochemicals. His 40 plus years of industry experience include ten years as Executive Director, Marketing for Fluor Daniel Canada; seven years as General Manager, Natural Gas Liquids for Petro-Canada; and three years as Manager, Offshore & International Joint Ventures for Petro-Canada. Prior to that, Mr. Skupa was employed in management and engineering positions with Pacific Petroleums, Esso Chemical Canada and Imperial Oil Limited. Mr. Skupa is one of the original shareholders of Calvalley and of its predecessor corporations. As well, he was also a director of the Company from July 1995 to May 1998.

**Thomas E. Valentine** is a partner with Macleod Dixon LLP, where he has practiced as both a barrister and a solicitor, with a focus on energy work, for more than 20 years. Mr. Valentine returned to Calgary in 2003 from Doha, Qatar where he held the position of Senior Counsel (Projects) with Qatar Petroleum, the national oil and gas company for the State of Qatar. Mr. Valentine is currently involved in a number of international energy projects, including projects in Qatar, Oman, Iran, Turkmenistan and the United Arab Emirates. His work experience includes liquefied natural gas, gas-to-liquids and petrochemicals, as well as conventional oil and gas transactions. Mr. Valentine holds a B.A. from the University of British Columbia, a LL.B. from Dalhousie University, and a LL.M. from the London School of Economics. He also serves on the boards of Veraz Petroleum and NXT Energy Solutions Inc.

**Kenneth M. Stephenson** is a graduate in Civil Engineering from the University of Saskatchewan. He is the owner of Kenaco Capital Services Inc. which holds private investments in several junior oil and gas companies, controlling interest in NARSTCO Inc., a steel railway tie manufacturer in Texas, a director and officer of MinMiner Oilsands Inc. and a director of Creative Door Services Ltd., Western Canada's largest garage and industrial door supplier. He has held private ownerships, directorships, and in some cases the position of Chief Executive Officer in the oil and gas industry in contract drilling, exploration and development, pipeline construction, manufacturing,

heavy construction, gas processing and oilfield camp and catering. During his career, Mr. Stephenson has held a number of diverse commercial/industrial interests and directorships in both private and public companies.

**Zacharie J. Magnan** is a Chartered Accountant with over 10 years of experience. Mr. Magnan has been employed by the Company since December 2008. Prior to joining the Company, he occupied various positions including Associate Partner with a Calgary based public accounting firm.

#### 2010 Shareholdings of the Board

As at December 31, 2010, the directors and officers of the Company collectively owned or controlled 1,151,314 Common Shares in the aggregate, being 1.2% of the outstanding Common Shares excluding the 18,415,059 Common Shares owned by Calvalley Financial Inc. as noted in note (1) above. Total shareholdings by directors and officers including those held by Calvalley Financial Inc., is 19,566,373 Common Shares, being 20.0% of the outstanding Common Shares (based on 97,714,280 issued and outstanding Common Shares).

As at March 31, 2010, the directors and officers of the Company collectively own or control 1,151,314 Common Shares in the aggregate, being 1.2% of the outstanding Common Shares as at March 31, 2010 excluding the 18,415,059 Common Shares owned by Calvalley Financial Inc. as noted in note (1) above. Total shareholdings by directors and officers including those held by Calvalley Financial Inc., is 19,586,373 Common Shares, being 20.1% of the outstanding Common Shares (based on 97,458,277 issued and outstanding Common Shares).

#### Committees of the Board

##### Audit Committee

The Audit Committee of Calvalley is comprised of Gary Robertson (Chairman), Ken Stephenson and Thomas Skupa. All members of the Audit Committee are independent and financially literate (as determined by Multilateral Instrument 52-110, *Audit Committees* ("MI 52-110")). The Audit Committee reviews the Company's interim unaudited consolidated financial statements and annual audited consolidated financial statements and certain corporate disclosure documents including the annual information form, and management's discussion and analysis before they are approved by the Board. The Committee reviews and makes a recommendation to the Board in respect of the appointment and compensation of the external auditor and it monitors accounting, financial reporting, control and audit functions.

The Audit Committee meets to discuss and review the audit plans of external auditors and is directly responsible for overseeing the work of the external auditor with respect to preparing or issuing the auditor's report or the performance of other audit, review or attest services, including the resolution of disagreements between management and the external auditor regarding financial reporting. The Audit Committee questions the external auditor independently of management and reviews a written statement of its independence based on the criteria found in the recommendations of the Canadian Institute of Chartered Accountants. The Audit Committee must be satisfied that adequate procedures are in place for the review of the Company's public disclosure of financial

information extracted or derived from its financial statements and it periodically assesses the adequacy of those procedures.

The Audit Committee must approve or pre-approve, as applicable, any non-audit services to be provided to the Company by the external auditor. In addition, it reviews and reports to the Board on the Company's risk management policies and procedures and reviews the internal control procedures to determine their effectiveness and to ensure compliance with the Company's policies and avoidance of conflicts of interest. The Committee has established procedures for dealing with concerns or confidential submissions which come to its attention with respect to accounting, internal accounting controls or auditing matters.

The Audit Committee Mandate and further disclosure with respect to the members and actions of the Audit Committee pursuant to MI 52-110 are included in Schedule B to this AIF.

#### Auditors

Deloitte & Touche LLP was first appointed as the auditor of the Company on June 9, 2005. Below is a table illustrating fees paid to Deloitte & Touche LLP for the years ended December 31, 2010 and December 31, 2009.

	Year Ended Dec. 31, 2010	Year Ended Dec. 31, 2009
<b>Audit</b>		
Audit of consolidated financial statements	\$110,000	\$109,500
Yemen Statutory Audit	25,750	19,600
Yemen Group Reporting	20,600	13,720
Audit of Calvalley Petroleum (Cyprus) Ltd.	10,000	-
Review of interim consolidated financial statements	35,500	42,000
Other / Consent	-	5,285
<b>Subtotal</b>	<b>201,850</b>	<b>190,105</b>
<b>Audit Related</b>		
IFRS related procedures	35,975	31,467
<b>Subtotal</b>	<b>35,975</b>	<b>31,467</b>
<b>Total Fees Charged</b>	<b>237,825</b>	<b>221,572</b>

## Compensation Committee

On September 27, 2005, the Board of Calvalley approved the creation of a Compensation Committee. The Compensation Committee's mandate was approved by the Board on March 21, 2006. The Compensation Committee of the Board has been established to address compensation matters and is comprised of a majority of independent directors. As at December 31, 2010, the Compensation Committee was comprised of Thomas Valentine (Chairman), Gary Robertson and Thomas Skupa.

With respect to compensation matters, the Compensation Committee has been mandated, among other things: (a) to recommend to the Board the terms for the compensation of directors, the Chief Executive Officer (the "CEO"), and such other employees of the Company or any subsidiary of the Company as may be identified to the Committee by the Board (collectively, the "Designated Employees") of the Company that adequately reflect the responsibilities they are assuming; (b) to review, revise and approve the position description of the CEO and recommend in conjunction with the participation of the CEO annual performance goals, objectives and criteria for the CEO, evaluate the performance of the CEO against such position description and applicable performance goals, objectives and criteria and make recommendations to the Board with respect to the CEO's level of compensation based on this evaluation; (c) to review the CEO's evaluation of the performance of the other officers of the Company appointed by the Board and Designated Employees and review the CEO's recommendations with respect to the amount of compensation to be provided to the Designated Employees; (d) to review and assess the competitiveness and appropriateness of and approve the compensation package of the CEO and each of the Designated Employees; (e) to review and approve any employment contracts or arrangements with the CEO and each of the Designated Employees, including any retiring allowance arrangements, severance payments or any similar arrangements to take effect in the event of a termination of employment and any change of control agreements; (f) to review and recommend to the Board compensation policies and processes and any new incentive compensation and equity compensation plans of the Company or changes to such plans and in particular, the compensation policies, processes and plans respecting the CEO and the Designated Employees; (g) to review and recommend to the Board the overall parameters of the Company's multi-year incentive plans, if any, including recommending who should be eligible to participate under these plans and changes to such plans; and (h) to review and recommend to the Board the Designated Employees to be included as participants in the Company's stock option plan.

## Reserves Committee

The Reserves Committee is comprised of Kenneth Stephenson (Chairman), Memet Kont and Thomas Skupa. The Reserves Committee mandate was approved by the Board on March 21, 2006 and amended November 7, 2006. As the majority of the Committee members are independent directors, the requirements established by National Instrument 51-101, Standards of Disclosure for Oil and Gas Activities are met. The Reserves Committee is responsible for ensuring that management has designed and implemented effective reserves programs, controls and reporting systems. The Reserves Committee's mandate also includes reviewing the independent reserves evaluation of the Company and any public disclosure of reserves and other oil and gas information and reviewing and approving any proposals to change the evaluating

engineers. The Reserves Committee communicates regularly with management to ensure that all reserves evaluations and reports have been properly handled and reported.

#### Disclosure Committee

The Disclosure Committee is comprised of Ed Shmoon (Chairman), Thomas Valentine and Memet Kont. The Board approved the Company's Disclosure Policy on March 21, 2006. The Disclosure Committee oversees the Company's disclosure practices and is responsible for all regulatory disclosure. Further, the Committee is responsible for designing and implementing appropriate systems, processes and controls for disclosure and reviews all news releases and material disclosure documents prior to their release or filing.

#### Corporate Governance Committee

The Corporate Governance Committee is comprised of Ed Shmoon (Chairman), Thomas Valentine and Memet Kont. The Committee is responsible for overseeing and assessing the functioning of the Board and the committees of the Board and for the development, recommendation to the Board, implementation and assessment of effective corporate governance principles and guidelines.

The Committee's responsibilities also include identifying candidates for director and recommending that the Board select qualified director candidates for election at the next Annual Meeting of shareholders. The Committee shall undertake on behalf of the Board such other corporate governance initiatives as may be necessary or desirable to enable the Board to provide effective corporate governance for the Company and contribute to the success of the Company and enhance shareholder value.

#### Cease Trading Orders, Bankruptcies, Penalties or Sanctions

None.

#### Conflicts of Interest

The directors and officers of Calvalley may be engaged in other activities in the oil and natural gas industry and, as a result of these and other activities, the directors and officers of Calvalley may become subject to conflicts of interest. Directors, Officers and employees must ensure that no conflict exists between their personal interests and those of the Company. Directors, officers and employees are to avoid placing themselves in positions that may be perceived as conflicts. In the event that a director, officer or employee has an interest in a contract or proposed contract or agreement, the director, officer or employee shall disclose his interest in such contract or agreement and shall refrain from participating in any matter in respect of such contract or agreement unless otherwise agreed to by the Chief Executive Officer of the Company. To the extent that conflicts of interest arise, such conflicts will be resolved in accordance with the provisions of the CBCA. The business of Calvalley is subject to other risks and matters, which may fall outside of the control of the directors, officers and employees of the Company.

## **LEGAL PROCEEDINGS**

The Company has been named in a claim filed in the Commercial Court of Yemen by a Saudi Arabian company. The claimant alleges that, pursuant to an agency agreement entered into in 1996, it is entitled to a percentage of the net profit attributable to the Company. Over the past several years this issue has been before the Commercial Court of Yemen, the Yemeni Court of Appeal and the Supreme Court of Yemen on a number of procedural issues and has now been sent back to the Supreme Court of Yemen for reassessment. Interim judgments have been issued and both parties appealed an initial ruling which limited the plaintiff's entitlement to an interest on the net profit from profit oil production prior to February, 2008. Calvalley has cross-appealed on a number of matters of substance and procedure.

The Company's legal advisors in Sana'a and Calgary are pursuing the appeal jointly. The outcome of the action in the Supreme Court of Yemen is undeterminable at this time and the Company is exploring both judicial, and extra judicial, resolution. No amounts have been accrued in the consolidated financial statements for the periods ended September 30, 2010 as the ultimate resolution is uncertain. The Company will record any amounts due, if any, once the outcome of the contingency is likely and reasonably estimated.

Between 2004 and 2007, the Company billed its Block 9 joint venture partners (JV Partners) for fees in accordance with the terms of the PSA which governs the joint venture operating activities on Block 9. The JV Partners contend that certain of these fees are not billable under the terms of the Joint Operating Agreement (JOA) between the Company and the JV Partners. Pending resolution of this matter, the Company has not charged the JV Partners for the fees in question during 2008 and 2009. The Company and its JV Partners have now agreed to enter into a binding expert determination in London, England to interpret the terms of the JOA and to obtain a ruling on whether the fees in question are billable. While management is not able to determine the likelihood of a positive or negative outcome, the maximum liability to the Company related to fees charged from 2004 to 2007 is \$1,012. Conversely, should the fees be deemed billable, the Company would recover fees which have not previously been recorded in the accounts in the amount of \$927.

In the normal course of operations, the Company may be subject to litigation and claims. In the opinion of management, other than as disclosed above, no such litigation or claim, individually or in aggregate, would result in a liability that would have a significant adverse effect on the financial position or results of operations of the Company.

## **INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS**

No director or executive officer of Calvalley, no person or company that is the direct or indirect beneficial owner of, or who exercises control or direction over more than 10% of the outstanding Common Shares and no associate or affiliate of any of the foregoing persons or companies, has or has had any material interest, direct or indirect, in any transaction within the three most recently completed financial years or during the current financial year that has materially affected or will materially affect Calvalley or its subsidiaries.

## **TRANSFER AGENTS AND REGISTRARS**

The transfer agent and registrar for the Common Shares is Computershare Investor Services Inc. at its principal offices in Calgary, Alberta and Toronto, Ontario.

## **MATERIAL CONTRACTS**

Other than as set forth below, there are no material contracts entered into by Calvalley or its subsidiaries during the most recently completed financial year or since January 1, 2002 and which are still in effect, other than contracts entered into in the ordinary course of business.

1. Production Sharing Agreement, dated February 23, 1997 (see “Description of the Business –The Block 9 Production Sharing Agreement”);
2. Joint Operating Agreement, dated November 1, 2001 (see “Description of the Business - The Joint Operating Agreement and Participation Agreement in Respect of Block 9”);
3. Participation Agreement, dated January 8, 2002 (see “Description of the Business – The Joint Operating Agreement and Participation Agreement in Respect of Block 9”); and

## **INTERESTS OF EXPERTS**

As at the date of this AIF, principals of McDaniel & Associates Consultants Ltd., independent petroleum consultants to Calvalley, personally disclosed in certificates of qualification that they neither owned nor expected to receive any of the outstanding Common Shares as compensation. The auditors of the Company, Deloitte & Touche LLP, are independent with respect to the Company, in accordance with the Rules of Professional Conduct of the Institute of Chartered Accountants of Alberta.

## **ADDITIONAL INFORMATION**

Additional information relating to Calvalley may also be found on SEDAR at [www.sedar.com](http://www.sedar.com).

Additional information, including that related to directors' and officers' remuneration and indebtedness, principal holders of Calvalley's securities, options to purchase Calvalley's securities and interest of insiders in material transactions, where applicable, is contained in the Company's information circular prepared in respect of the Annual General Meeting of Shareholders to be held on May 9, 2011. Additional financial information is provided in the Company's comparative financial statements for the year ended December 31, 2010 and related Management Discussion and Analysis, which can be found in the Company's 2010 Annual Report to Shareholders.

Copies of the information circular, the financial statements, including any interim financial statements, and additional copies of this AIF may be obtained from the Corporate Secretary of the Company at the registered office of Calvalley, 3700, 400 – 3rd Avenue SW, Calgary, Alberta, T2P 4H2, telephone (403) 267-8222, facsimile (403) 264-5973.

**SCHEDULE A-1: FORM 51-101F1**

**CALVALLEY PETROLEUM INC.**

**FORM 51-101F1**

**STATEMENT OF RESERVES DATA  
AND OTHER OIL AND GAS INFORMATION**

Statements in this document may contain forward-looking information. Estimates provided for 2011 and beyond are based on assumptions of future events and actual results could vary significantly from these estimates. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. Events or circumstances may cause actual results to differ materially from those predicted as a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of Calvalley Petroleum Inc. (the "Company" or "Calvalley") as outlined below. The reader is cautioned not to place undue reliance on this forward-looking information. All dollar values in this report are expressed in United States currency.

**Relevant Dates**

**Date of Statement and Statement Information**

This Statement of Reserves Data and Other Oil and Gas Information (the "**Statement**") is dated February 28, 2011. The effective date of the information provided in the Statement is December 31, 2010 unless otherwise indicated. The information was prepared between December 31, 2010 and February 28, 2011.

**Disclosure of Reserves Data**

The following is a summary of the oil and natural gas reserves and the net present values of future net revenue of the Company as evaluated by McDaniel & Associates Consultants Ltd. ("McDaniel") who are independent qualified reserves evaluators appointed by Calvalley pursuant to National Instrument 51-101 – *Standards of Disclosure for Oil and Gas Activities* ("NI 51-101"). Substantially all of the Company's oil and gas properties were independently evaluated by McDaniel, who has provided the Company with a report dated February 28, 2011 regarding the Company's estimates of its oil and natural gas reserves as at December 31, 2010 (the "McDaniel Report") and has consented in writing to the inclusion of information contained in the McDaniel Report.

The Company determines and reports reserves information in accordance with NI 51-101, using terminology and definitions prescribed therein. The Company believes that the reserve quantities are reasonable estimates consistent with current knowledge of the characteristics and extent of the productive formations. In the future, the Company may revise its estimates based on additional information including the performance of producing reservoirs, technological improvements and changes in economic conditions.

The Company's disclosure of reserves or resources is consistent with the reserves and resources terminology and categories set out in the COGE Handbook. Disclosure of

reserves or of sales of oil, gas or associated by-products has been made only in respect of marketable quantities, reflecting prices for the product in the condition (upgraded or not upgraded, processed or unprocessed) in which it is to be, or was, sold.

The estimated future net revenue figures contained in the following tables do not necessarily represent the fair market value of the Company's reserves. There is no assurance that the forecast price and cost assumptions contained in the McDaniel Report will be attained and variances could be material. Other assumptions relating to costs and other matters are included in the McDaniel Report. The recovery and reserves estimates attributed to the Company's properties described herein are estimates only. The actual reserves attributed to the Company's properties may be greater or less than those calculated.

The determination of oil and gas reserves involves the preparation of estimates that have an inherent degree of associated uncertainty. Categories of proved, probable, and possible reserves have been established to reflect the level of these uncertainties and to provide an indication of the probability of recovery. The estimation and classification of reserves requires the application of professional judgment combined with geological and engineering knowledge to assess whether or not specific reserves classification criteria have been satisfied. Knowledge of concepts including uncertainty and risk, probability and statistics, and deterministic and probabilistic estimation methods is required to properly use and apply reserves definitions. These concepts are presented and discussed in greater detail within the guidelines in Section 5.5 of the COGE Handbook.

The following definitions apply to both estimates of individual reserves entities and the aggregate of reserves for multiple entities:

"Reserves" are estimated remaining quantities of oil and natural gas and related substances anticipated to be recoverable from known accumulations, from a given date forward, based on:

- analysis of drilling, geological, geophysical and engineering data;
- the use of established technology; and
- specified economic conditions, which are generally accepted as being reasonable, and which are disclosed.

Reserves are classified according to the degree of certainty associated with the estimates:

- "Proved reserves" are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated proved reserves.
- "Probable reserves" are those additional reserves that are less certain to be recovered than proved reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves.
- "Possible reserves" are those additional reserves that are less certain to be

recovered than probable reserves. It is unlikely that the actual remaining quantities recovered will exceed the sum of the estimated proved plus probable plus possible reserves.

Other criteria that must also be met for the categorization of reserves are provided in Section 5.5 of the COGE Handbook.

#### *Development and Production Status*

Each of the reserves categories (proved, probable and possible) may be divided into developed and undeveloped categories:

- “Developed reserves” are those reserves that are expected to be recovered from existing wells and installed facilities or, if facilities have not been installed, that would involve a low expenditure (for example, when compared to the cost of drilling a well) to put the reserves on production. The developed category may be subdivided into producing and non-producing.
- “Developed producing reserves” are those reserves that are expected to be recovered from completion intervals open at the time of the estimate. These reserves may be currently producing or, if shut-in, they must have previously been on production, and the date of resumption of production must be known with reasonable certainty.
- “Developed non-producing reserves” are those reserves that either have not been on production, or have previously been on production, but are shut-in, and the date of resumption of production is unknown.
- “Undeveloped reserves” are those reserves expected to be recovered from known accumulations where a significant expenditure (for example, when compared to the cost of drilling a well) is required to render them capable of production. They must fully meet the requirements of the reserves classification (proved, probable, possible) to which they are assigned.

In multi-well pools it may be appropriate to allocate total pool reserves between the developed and undeveloped categories or to subdivide the developed reserves for the pool between developed producing and developed non-producing. This allocation should be based on the estimator’s assessment as to the reserves that will be recovered from specific wells, facilities and completion intervals in the pool and their respective development and production status.

#### *Levels of Certainty for Reported Reserves*

The qualitative certainty levels referred to in the definitions above are applicable to individual reserves entities (which refers to the lowest level at which reserves calculations are performed) and to reported reserves (which refers to the highest-level sum of individual entity estimates for which reserves estimates are presented).

Reported reserves should target the following levels of certainty under a specific set of economic conditions:

- at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated proved reserves;
- at least a 50 percent probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable reserves; and
- at least a 10 percent probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable plus possible reserves.

A quantitative measure of the certainty levels pertaining to estimates prepared for the various reserves categories is desirable to provide a clearer understanding of the associated risks and uncertainties. However, the majority of reserves estimates will be prepared using deterministic methods that do not provide a mathematically derived quantitative measure of probability. In principle, there should be no difference between estimates prepared using probabilistic or deterministic methods.

Additional clarification of certainty levels associated with reserves estimates and the effect of aggregation is provided in Section 5.5.3 of the COGE Handbook.

#### *Significant Factors or Uncertainties*

Aside from the potential impact of material fluctuations in commodity prices and foreign exchange rates, other significant factors or uncertainties that may affect either the Company's reserves or the future net revenue associated with such reserves include:

- Certain newly drilled or developed properties may be considered less predictable insofar as estimating reserves and future net revenue are concerned until more historical production performance data is available; and
- Changes to existing taxation, fiscal terms, and regulations may occur in the future.

#### *Reserves Data - Forecast Prices and Costs*

The following table discloses, in the aggregate, the Company's gross and net reserves, estimated using forecast prices and costs, by product type classified as to proved, probable and possible categories. "Forecast prices and costs" means future prices and costs used by McDaniel in the McDaniel Report that are generally accepted as being a reasonable outlook of the future, or fixed or currently determinable future prices or costs to which the Company is bound.

Possible reserves are those additional reserves that are less certain to be recovered than probable reserves. There is a 10% probability that the quantities actually recovered will equal or exceed the sum of proved plus probable plus possible reserves.

<b>Table 2.1.1 Summary of Oil Reserves As At December 31, 2010 Forecast Prices and Costs (Thousands of Barrels)</b>						
	<b>Light and Medium Oil</b>		<b>Heavy Oil</b>		<b>Total</b>	
	<b>Gross</b>	<b>Net</b>	<b>Gross</b>	<b>Net</b>	<b>Gross</b>	<b>Net</b>
<b>Proved</b>						
Developed producing	3,806	2,263	-	-	3,806	2,263
Developed non-producing	3,806	2,146	884	498	4,691	2,644
Undeveloped	7,090	3,109	3,537	1,634	10,627	4,743
<b>Total proved</b>	10,896	5,255	4,421	2,132	15,317	7,387
<b>Probable</b>	13,890	5,936	2,315	909	16,205	6,845
<b>Total proved plus probable</b>	24,786	11,191	6,736	3,041	31,522	14,232
<b>Possible</b>	13,287	5,079	2,354	843	15,641	5,923
<b>Total</b>	38,072	16,270	9,090	3,885	47,163	20,155
(1) Gross reserves are based on the Company's working interest, before Government share of production. Net reserves represent the Company's expected share of gross reserves under the terms of the Production Sharing Agreement.						

	<b>NGL</b>	
	<b>Gross</b>	<b>Net</b>
<b>Proved</b>		
Developed producing	-	-
Developed non-producing	-	-
Undeveloped	256	120
<b>Total proved</b>	256	120
<b>Probable</b>	46	41
<b>Total proved plus probable</b>	302	134
<b>Possible</b>	139	52
<b>Total</b>	441	186

The following table discloses, in the aggregate, the net present value of the Company's future net revenue attributable to the reserves categories in the previous table, estimated using forecast prices and costs, and calculated without discount and using discount rates of 5%, 10%, 15% and 20%.

	<b>0%</b>	<b>5%</b>	<b>10%</b>	<b>15%</b>	<b>20%</b>
<b>Before Income Taxes</b>					
<b>Proved</b>					
Developed producing	116,689	103,539	93,226	84,952	78,180
Developed non-producing	140,630	125,202	113,059	103,285	95,263
Undeveloped	298,811	236,586	193,050	161,475	137,854
<b>Total proved</b>	439,441	361,787	306,109	264,759	233,117
<b>Probable</b>	489,975	361,426	277,511	220,185	179,464
<b>Total proved + probable</b>	929,415	723,213	583,621	484,945	412,581
<b>Possible</b>	542,917	359,774	255,102	190,570	148,184
<b>Total proved + probable + possible</b>	1,472,332	1,082,988	838,723	675,515	560,764
<b>After Income Taxes</b>					
<b>Proved</b>					
Developed producing	92,749	83,275	75,714	69,553	64,440
Developed non-producing	108,260	97,612	89,101	82,154	76,377
Undeveloped	193,684	153,494	125,337	104,906	89,625
<b>Total proved</b>	301,944	251,106	214,439	187,060	166,002
<b>Probable</b>	318,968	235,008	180,246	142,870	116,346
<b>Total proved + probable</b>	620,912	486,114	394,685	329,930	282,348
<b>Possible</b>	352,502	233,260	165,009	122,880	95,183
<b>Total proved + probable + possible</b>	973,415	719,374	559,694	452,809	377,531

The following table discloses, in the aggregate, certain elements of the Company's future net revenue attributable to its proved reserves, estimated using constant prices and costs.

<b>Table 2.1.3 Total Future Net Revenue As at December 31, 2010 Forecast Prices and Costs (Thousands of Dollars)</b>			
	<b>Proved</b>	<b>Proved and Probable</b>	<b>Proved Probable and Possible</b>
<b>Undiscounted:</b>			
Cost oil revenue <sup>(1)</sup>	305,179	483,035	553,511
Profit oil revenue <sup>(2)</sup>	392,848	881,437	1,425,479
Operating costs	207,759	346,818	354,431
Abandonment and reclamation costs	1,611	-	-
Development costs	46,067	84,863	147,727
Bonus payments	3,150	3,375	4,500
Future net revenue before income taxes	439,441	929,415	1,472,332
Deemed Income taxes <sup>(3)</sup>	137,497	308,503	498,918
Future net revenue after income taxes	301,944	620,912	973,415
<b>Future net revenue before income taxes, discounted at 10% per annum</b>			
Light and medium oil	214,172	454,550	670,794
Heavy oil	86,904	123,538	160,165
NGLs	5,033	5,532	7,764
Total	306,109	583,621	838,723
<b>Unit Value before income taxes (discounted at 10% per annum) \$/bbl</b>			
Light and medium oil	40.76	40.62	41.23
Heavy oil	40.76	40.62	41.23
NGL	41.92	41.39	41.85
<b>Notes</b>			
1) Revenues are based on the Company's working interest, after deducting the Government's share of production, but before income tax withheld by the Government.			
2) The pre-tax profit revenue is net of royalties.			
3) The income tax is paid by the Government of Yemen out of Calvalley's share of profit revenues. The pretax revenues were grossed up by the deemed income taxes.			

### **Item 2.3 Reserves Disclosure**

The Company has a 50% working interest in Block 9, Republic of Yemen, and the interest is held 100% by the Company's wholly-owned subsidiary.

The Company has no additional overrides, encumbrances or minority interests other than a commitment to pay \$1.25 per barrel of production attributed to the Company, up to a maximum of \$5.125 million. As at December 31, 2010, future payments related to this commitment amount to \$2.217 million.

## Item 2.4 Future Net Revenue Disclosure

All of the Company's properties are held by the Company or its wholly-owned subsidiary, Calvalley Petroleum (Cyprus) Ltd.

Future net revenues are calculated in accordance with the terms of the Block 9 Production Sharing Agreement. Since the Government pays the profit taxes on the Company's share of profit oil, out of the Government's share of profit oil, future net revenues before tax include the value of such profit taxes.

### 3. Pricing Assumptions

#### Reference Prices Used in Estimates

During 2010, the Company received an average price of \$80.03 per barrel for oil sold. Forecast reference prices used in the forecast price analysis were provided in the McDaniel report and are summarized in the table below:

Table 3 Summary of Pricing and Inflation Rate Assumptions As At December 31, 2010									
	Benchmark	Crude Oil Selling Prices							
	Brent	Hiswah Saar Naifa	Hiswah Qishn	Al Roidhat Qishn	Auqban Shuqra	Ras Noor Harshiyat	Ras Nowmah Qishn	Qarn Qaymah	Inflation Rate
		(\$US/bbl)	(\$US/bbl)	(\$US/bbl)	(\$US/bbl)	(\$US/bbl)	(\$US/bbl)	(\$US/bbl)	
Forecast prices and costs									
2011	85.00	84.44	84.44	84.44	84.44	84.44	84.44	84.44	2.0%
2012	87.20	86.69	86.69	86.69	86.69	86.69	86.69	86.69	2.0%
2013	89.50	88.98	88.98	88.98	88.98	88.98	88.98	88.98	2.0%
2014	92.30	91.24	91.24	91.24	91.24	91.24	91.24	91.24	2.0%
2015	95.20	93.58	93.58	93.58	93.58	93.58	93.58	93.58	2.0%
2016	98.30	96.64	96.64	96.64	96.64	96.64	96.64	96.64	2.0%
2017	100.30	98.61	98.61	98.61	98.61	98.61	98.61	98.61	2.0%
2018	102.30	100.58	100.58	100.58	100.58	100.58	100.58	100.58	2.0%
2019	104.20	102.44	102.44	102.44	102.44	102.44	102.44	102.44	2.0%
2020	106.40	104.61	104.61	104.61	104.61	104.61	104.61	104.61	2.0%
2021	108.50	106.67	106.67	106.67	106.67	106.67	106.67	106.67	2.0%
2022	110.70	108.83	108.83	108.83	108.83	108.83	108.83	108.83	2.0%
2023	112.80	110.90	110.90	110.90	110.90	110.90	110.90	110.90	2.0%
2024	115.10	113.16	113.16	113.16	113.16	113.16	113.16	113.16	2.0%
2025	117.50	115.52	115.52	115.52	115.52	115.52	115.52	115.52	2.0%
2026	119.85	117.83	117.83	117.83	117.83	117.83	117.83	117.83	2.0%
2027	122.25	120.19	120.19	120.19	120.19	120.19	120.19	120.19	2.0%
2028	124.69	122.59	122.59	122.59	122.59	122.59	122.59	122.59	2.0%
2029	127.19	125.04	125.04	125.04	125.04	125.04	125.04	125.04	2.0%
2030	129.73	127.54	127.54	127.54	127.54	127.54	127.54	127.54	2.0%
Thereafter	+2%/yr	+2%/yr	+2%/yr	+2%/yr	+2%/yr	+2%/yr	+2%/yr	+2%/yr	2.0%

#### 4. Reconciliation of Changes in Reserves and Future Net Revenue

##### Reserves Reconciliation

The following table provides a reconciliation of Calvalley's gross reserves based on forecast prices and costs.

	Light and Medium Oil			Heavy Oil			NGL		
	Proved	Probable	Proved and Probable	Proved	Probable	Proved and Probable	Proved	Probable	Proved and Probable
<b>As at December 31, 2009</b>	6,501	10,758	17,259	5,177	3,842	9,019	229	33	262
Extensions	2,686	727	3,413	-	-	-	-	-	-
Infill Drilling	-	-	-	-	-	-	-	-	-
Improved recovery	-	-	-	-	-	-	-	-	-
Technical revisions	1,769	874	2,642	10	5	15	27	13	40
Other	766	1,532	2,297	(766)	(1,532)	(2,297)			
Discoveries	-	-	-	-	-	-	-	-	-
Acquisitions	-	-	-	-	-	-	-	-	-
Dispositions	-	-	-	-	-	-	-	-	-
Economic factors	-	-	-	-	-	-	-	-	-
Production	(825)	-	(825)	-	-	-	-	-	-
<b>As at December 31, 2010</b>	10,896	13,890	24,786	4,422	2,315	6,737	256	46	302

Other refers to the re-categorization of the reserves assigned to Ras Nowmah from heavy oil at December 31, 2009 to light and medium oil at December 31, 2010 due to additional test data and oil samples.

Reserves additions were largely attributable to the successful testing of light oil at the Ras Nowmah 2 appraisal well which resulted in a higher recovery factor.

In addition, better than expected well performance from Hiswah producers as well as five new oil producer wells drilled during 2010 contributed to reserves re-classifications and additional new reserves being assigned.

During 2010, a reservoir pressure maintenance program at Hiswah consisting of water and gas injection was initiated. The program is expected to enhance recovery of oil.

## 5. Additional Information Relating To Reserves Data

### Undeveloped Reserves

As of December 31, 2010				
Light/Medium Oil				
Heavy Oil				
Proved Undeveloped	1st		1st	
	Attributed (Mbbbl)	Booked (Mbbbl)	Attributed (Mbbbl)	Booked (Mbbbl)
Prior to 2008	-	1,716	-	3,718
2008	3,384	3,654	-	2,206
2009	786	4,181	-	3,530
2010	3,536	7,086	-	3,540
Probable Undeveloped	1st		1st	
	Attributed (Mbbbl)	Booked (Mbbbl)	Attributed (Mbbbl)	Booked (Mbbbl)
Prior to 2008	786	2,980	56	1,971
2008	1,899	5,395	26	2,310
2009	1,557	6,091	-	2,310
2010	1,850	6,856	-	2,316

The Proven Undeveloped Reserves reside primarily in Hiswah, Al Roidhat and Ras Nowmah fields and have been assigned by means of interpreted pool mapping where certain areas within the pool boundary do not currently have the required drilling/development to exploit these reserves effectively. The Ras Nowmah Field development plan is expected to start in the second quarter of 2011. In the case of the minor Proven Undeveloped Reserves additions in Qarn Qaymah and Auqban, additional capital for equipment and/or stimulation is budgeted within a two year time frame.

The Probable Undeveloped Reserves reside primarily in the Hiswah, Al Roidhat and Ras Nowmah fields. Probable reserves at the Hiswah Field have been attributed from the results of a simulation study. The water and gas injection project has started in the first quarter of 2011 with two water injectors and two gas injectors, and is expected to have a positive impact on our recovery factor. In all three cases development of these reserves is expected to commence within a two year period.

### Future Development Costs

The following table summarizes the development costs deducted in estimating future revenue attributable to the Company's reserves.

	Development Costs (Thousands of Dollars)	
	Proved	Proved and Probable
2011	13,277	18,307
2012	14,291	23,131
2013	12,320	19,106
2014	3,461	17,664
2015	916	2,181
Thereafter	1,802	4,475
Total	46,066	84,863

The Company expects that funds required to satisfy development costs will be obtained from internally generated cash flow, debt financing, and future equity financing.

## 6. Other Oil and Gas Information

### Oil and Gas Properties and Wells

Table 6 Summary of Oil and Gas Wells As at December 31, 2010				
	Producing		Non-Producing	
	Gross	Net	Gross	Net
Yemen	21	10.5	42	21
Note	1) Gross wells equal the total wells on Block 9 and net wells equal the Company's 50% working interest in gross wells.			

### The Exploration & Development Program

Calvalley is focused on exploration and development of Block 9 in the Republic of Yemen and exploration of the Gimbi and Metema Blocks in Ethiopia. Both blocks are located on-shore in their respective countries. Calvalley's principal assets and operations are related to its 50% working interest in the Production Sharing Agreement for Block 9, which consists of 2,234 km<sup>2</sup> (552,000 acres) of land within the prolific Sayun-Masila basin. Calvalley has made several significant hydrocarbon discoveries on Block 9. Calvalley declared commerciality during 2005 and started commercial production in December of that year.

Calvalley's production from Block 9 is predominantly from the Hiswah field which is comprised of 30 existing oil producer wells. The recent signing of transportation agreements is expected to allow the Company to commence the production of heavy oil from the Al-Roidhat field. Al Roidhat has been shut in pending the resolution of marketing arrangements for blended crude from Block 9. Calvalley expects that with the conclusion of the Transportation Agreements in February 2010 production from Al

Roidhat will commence in the second quarter of 2011.

Calvalley operates a Central Processing Facility near the Hiswah field with processes all production from Block 9 prior to the oil being transported to export facilities.

Recent exploration successes in 2008 and 2009 at Qarn Qaymah and Ras Nowmah are being evaluated to determine their productive capabilities. Additional appraisal wells are expected to be drilled in these areas. The Company operates a Central Processing Facility near the Hiswah field which processes and blends oil from all wells producing oil on Block 9.

Calvalley also owns a 100% working interest in a Production Sharing Contract ("PSC") in Ethiopia for the Metema and Gimbi blocks. The two blocks lie adjacent to the Sudan border, offsetting the Melut/Muglad and Blue Nile Basins, both of which are proven oil basins which form part of the Central African rift system. The Central African rift system is a series of Cretaceous to Tertiary-aged failed rifts that trend across Central Africa from the Benue Trough in Nigeria, through Chad, into Sudan.

#### *Block 9 Production Sharing Agreement and Joint Operating Agreement*

The Company has the right to explore for and to produce oil and natural gas on the Malik Block concession (Block 9) in the Shabwah/Hadramut region of central Yemen. Those rights are defined under the PSA that was ratified by Presidential Decree No. 21 on April 3, 1997. Under the terms of that PSA, the fiscal arrangements between the Company and the Government of Yemen are established, as are the conditions and procedures to convert from the original "exploration period", as extended, into the current twenty year "development period" that started on June 10, 2005.

By mutual agreement between Calvalley and the Government of Yemen, the first exploration period under the PSA for Block 9 was extended during the third quarter of 1999 for a period of two years ending April 4, 2002. In early 2002, the Government of Yemen granted Calvalley an additional one year extension for the first exploration period to April 4, 2003. In 2003, the Government of Yemen granted Calvalley an additional one year extension for the first exploration period to April 4, 2004 which was subsequently extended to October 4, 2004. In October 2004, the Company entered into the second exploration period under the PSA, at which time Calvalley relinquished 25% of the original surface area of Block 9, thereby reducing its land holdings to 3,546 km<sup>2</sup> from the original 4,728 square kilometre parcel.

Following the successful appraisal drilling of the Hiswah field, the Contractor declared Block 9 commercial. On June 19, 2005, the Contractor received approval from the Government of Yemen for commercial production from Block 9, allowing the Contractor to produce and sell oil. Commercial oil production from Block 9 began on December 10, 2005. The PSA is scheduled to expire on June 19, 2025 with provision for a five year extension.

In the evaluation of the Company's oil and gas reserves, the Company and its independent reserves evaluators have incorporated the production sharing formulas and other pertinent terms and provisions in the PSA and JOA.

Oil and gas production from Block 9 is allocated between the Contractor and agencies of

the Government of Yemen pursuant to the terms of the PSA. Under the JOA, Calvalley has a 50% working interest in all oil and gas production allocated under the PSA. The Government of Yemen receives a 10% royalty in kind from all Block 9 production, after which the remaining oil production is shared between the Contractor and the Government. The Contractor is first allocated up to 45% of gross production to recover capital and operating costs incurred to operate Block 9. To the extent that recoverable costs exceed 45% of the fair value of gross production, any excess costs are carried forward for recovery against future production. After deducting cost oil, the remaining oil is allocated between the state and the Contractor as follows:

- 39.23% of total profit oil (before deducting 35% income tax on Contractor's share of profit oil and after deducting 15% override to Yemen Co.) which is equivalent to 25.5% after deducting the income tax and the override; and
- 60.77% to the Government (including Yemen Co. override and excluding income tax on Contractor's share of profit oil)

Provided that total recoverable costs do not exceed 45% of gross production, the Contractor may recover operating costs during the year in which they are incurred and may deduct 50% of capital costs incurred during the year of expenditure and 50% during the following year.

As at December 31, 2010, the Company's share of capital costs to be carried forward for recovery against future production was approximately \$51 million. Until these costs have been recovered, together with future operating and capital costs that become eligible for recovery during that time period, the Company's net oil production will equal 31.33% of the Block's gross oil production (22.5% from cost oil and 8.83% from profit oil), which is equivalent to 62.654% of the Company's 50% working interest in gross oil production. Following full recovery of past operating costs, the Company's net oil production will range between 17.65% and 31.33% of the Block's gross oil production, which will vary depending upon prevailing oil and gas selling prices and the capital and operating costs incurred by the Contractor. The Company's share of profit oil is subject to 35% income tax to the Government and is paid from the Government's share of profit oil.

#### Properties with No Attributed Reserves

Calvalley's unproved properties include the Metema and Gimbi blocks which cover a total area of 46,470 km<sup>2</sup> (11.5 million acres) in Ethiopia. Calvalley has a 100% operated working interest, in both blocks for an exploration period of eight (8) years, consisting of an initial period of four (4) years followed by two (2) subsequent Option periods consisting of two (2) years each. The Option periods will be activated at the discretion of Calvalley. Furthermore, subject to hydrocarbon discovery during the total eight year period, the PSC provides for an additional twenty five (25) year development period with a ten (10) year optional extension. The PSC gives Calvalley the rights to explore, develop, and produce all kinds of hydrocarbons including oil, condensate, natural gas and associated liquids.

Total work obligations under the PSC, during the initial 4 year exploration program consist of acquisition and processing of 400 km of 2D seismic and drilling of one exploration well.

### Forward Contracts

There are no forward contracts, forward sales, transportation commitments or any other agreement that would influence the Company's strategy to develop the Block 9 reserves.

The PSA governs the terms of the relationship between the Government of Yemen and the Company exclusively, specifically the percentage of profit oil the Government is entitled to. The PSA also outlines the tax structure between the parties and how taxes are to be applied to production. All other contracts necessary for carrying on the business by the Company, including all third party service agreements and marketing and/or sales agreements, are independent of the PSA. The PSA does require tendering for all work activity and contracts are awarded based upon the analysis of bids.

### Abandonment and Restoration Costs

Block 9 is situated in a desert environment, located in the Wadi Hadramut region of central Yemen. There is very limited vegetation and migrating sand dunes tend to limit the success of agriculture. The Company employs international standards regarding the environment and all aspects of exploration and development activity are subject to environmental impact analysis.

For the ongoing development of Block 9, the Company follows international environmental standards in conducting its drilling operations and the construction and operations of temporary and permanent production facilities, pipelines and other infrastructure.

Environmental impacts related to well site preparation and drilling operations (including cuttings pits, water pits and camp facilities) are reclaimed following completion of every well so as to minimize ongoing surface disturbance during the subsequent operation of the wells. Depleted and unsuccessful wells are properly abandoned and their sites are restored to original conditions.

Sites used for construction and operation of permanent production facilities, pipelines, power lines and related uses are designed to minimize environmental disturbance related to their ongoing use. The Company incorporates international environmental practices in the design, construction and operation of such infrastructure, all of which are subject to licensing and other regulatory approvals from the Government of Yemen. Reclamation of such sites will not be required so long as the infrastructure is used in connection with oil and gas operations within Block 9.

All costs related to the Company's abandonment and reclamation obligations are incorporated into the calculations of net revenues related to its oil and gas reserves. The aggregate of such costs is \$1,610,500 without discount and \$445,000 discounted at 10% per annum. None of these costs are expected to be paid within the next three years.

### Tax Horizon

The Company is not subject to income taxes on its oil and gas operations, other than income taxes payable to the Government of Yemen. Pursuant to the Block 9 Production Sharing Agreement, the Company is subject to income tax at the rate of 35% and is paid

from the Government's share of profit oil. Taxable income is approximately equal to profit oil revenue, as cost oil revenue is fully offset by deduction of the related operating and capital costs recovered under the Production Sharing Agreement. The Company has non-capital losses of \$16.8 million available to carry forward for deduction against future years' Canadian taxable income.

Capital Expenditures

The following table summarizes the capital expenditures including capitalized general and administrative expenses related to the Company's activities for the year ended December 31, 2010:

	Yemen \$000	Ethiopia \$000	Total \$000
Property acquisition costs			
Proved properties	-	-	-
Unproved properties	-	-	-
Exploration costs	8,393	568	8,961
Development costs	12,076	-	12,076

Drilling Activity

Table 6.7 Summary of Wells Drilled Year Ended December 31, 2010						
	Exploratory		Development		Total	
	Gross	Net	Gross	Net	Gross	Net
Oil	1	0.5	5	2.5	6	3
Gas	-	-	-	-	-	-
Suspended	-	-	1	0.5	1	0.5
Water	-	-	-	-	-	-
Injector	-	-	-	-	-	-
Dry	1	-	-	-	1	0.5
Total	2	1	6	3	8	4
Note						
1) Gross wells equal the total wells drilled during 2010 and net wells equal the Company's 50% working interest in gross wells drilled during the year.						

Production Estimates

During 2011, light and medium oil is forecast to be produced from the Hiswah Field, Saar formation, as well as from the Auqban and Ras Nowmah Fields from the Qishn formation. All heavy oil production is forecast to be produced from the Al Roidhat Field. The following table summarizes the Company's estimated production volumes for 2011 for each product type:

<b>Forecast prices and costs</b>	<b>Heavy Oil</b>	<b>Light/Medium Oil</b>	<b>Total</b>
<b>Total Proved - Gross</b>			
Hiswah Field	-	920	920
Ras Nowmah Field	-	548	548
Al Roidhat Field	277	-	277
Other	-	10	10
Total	277	1,477	1,754
<b>Total Proved - Net</b>			
Hiswah Field	-	576	576
Ras Nowmah Field	-	343	343
Al Roidhat Field	173	-	173
Other	-	6	6
Total	173	926	1,099
<b>Proved and probable - Gross</b>			
Hiswah Field	-	993	993
Ras Nowmah Field	-	730	730
Al Roidhat Field	318	-	318
Other	-	14	14
Total	318	1,737	2,055
<b>Proved and probable - Net</b>			
Hiswah Field	-	622	622
Ras Nowmah Field	-	457	457
Al Roidhat Field	199	-	199
Other	-	9	9
Total	199	1,088	1,288
<b>Note</b>			
Gross oil production equals the Company's 50% working interest in forecast total production from Block 9.			

Production History

During 2010, most of the Company's production was produced from the Hiswah Saar field with some production from Qarn Qaymah well tests. The following table summarizes the Company's oil and gas production history:

<b>Table 6.9 Production History Year Ended December 31, 2010</b>					
	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Total</b>
<b>Company gross oil production (mbbls)</b>					
Hiswah Saar field	413,770	419,173	415,149	398,715	1,646,807
Qarn Qaymah	867	-	-	-	867
<b>Total</b>	<b>414,637</b>	<b>419,173</b>	<b>415,149</b>	<b>398,715</b>	<b>1,647,674</b>
<b>Average netback (\$/bbl)</b>					
Revenue	75.91	84.70	76.10	85.44	80.03
Royalties	(29.09)	(33.25)	(28.96)	(32.43)	(30.59)
Operating costs	(9.92)	(13.49)	(13.35)	(13.91)	(12.73)
Taxes	(4.69)	(5.23)	(4.70)	(5.28)	(4.94)
<b>Netback</b>	<b>32.21</b>	<b>32.73</b>	<b>29.09</b>	<b>33.82</b>	<b>31.77</b>

**SCHEDULE A-2: FORM 51-101F2**

February 28, 2011

**Calvalley Petroleum Inc.**  
700, 600 – 6<sup>th</sup> Avenue SW  
Calgary, Alberta  
T2P 0S5

Attention: The Board of Directors of Calvalley Petroleum Inc.

**Re: Form 51-101F2**  
**Report on Reserves Data by an Independent Qualified Reserves Evaluator**  
**of Calvalley Petroleum Inc. (the “Company”)**

To the Board of Directors of Calvalley Petroleum Inc. (the “Company”):

1. We have evaluated the Company’s reserves data as at December 31, 2010. The reserves data are estimates of proved reserves and probable reserves and related future net revenue as at December 31, 2010, estimated using forecast prices and costs.
2. The reserves data are the responsibility of the Company’s management. Our responsibility is to express an opinion on the reserves data based on our evaluation.

We carried out our evaluation in accordance with standards set out in the Canadian Oil and Gas Evaluation Handbook (the “COGE Handbook”) prepared jointly by the Society of Petroleum Evaluation Engineers (Calgary Chapter) and the Canadian Institute of Mining, Metallurgy & Petroleum (Petroleum Society).

3. Those standards require that we plan and perform an evaluation to obtain reasonable assurance as to whether the reserves data are free of material misstatement. An evaluation also includes assessing whether the reserves data are in accordance with principles and definitions presented in the COGE Handbook.
4. The following table sets forth the estimated future net revenue (before deduction of income taxes) attributed to proved plus probable reserves, estimated using forecast prices and costs and calculated using a discount rate of 10 percent, included in the reserves data of the Company evaluated by us, for the year ended December 31, 2010, and identifies the respective portions thereof that we have evaluated, audited and reviewed and reported on to the Company’s management:

Preparation Date of Evaluation Report	Location of Reserves	Net Present Value of Future Net Revenue \$M (before income taxes, 10% discount rate)			
		Audited	Evaluated	Reviewed	Total
February 28, 2011	Yemen	-	583,621	-	583,621

5. In our opinion, the reserves data evaluated by us have, in all material respects, been determined and are in accordance with the COGE Handbook. We express no opinion on the reserves data that we reviewed but did not audit or evaluate.
6. We have no responsibility to update our report referred to in paragraph 4 for events and circumstances occurring after the preparation date.
7. Because the reserves data are based on judgments regarding future events, actual results will vary and the variations may be material.

Executed as to our report referred to above:

**McDANIEL & ASSOCIATES CONSULTANTS LTD.**

“signed by B. H. Emslie”

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B. H. Emslie, P. Eng.

Calgary, Alberta

Date: February 28, 2011

**SCHEDULE A-3: FORM 51-101F3**

**CALVALLEY PETROLEUM INC. FORM 51-101F3 REPORT OF MANAGEMENT AND DIRECTORS ON CALVALLEY RESERVES DATA AND OTHER OIL AND GAS INFORMATION**

FORM 51-101F3

**REPORT OF MANAGEMENT AND DIRECTORS  
ON RESERVES DATA AND OTHER INFORMATION**

Management of Calvalley Petroleum Inc. (the "Company") are responsible for the preparation of and disclosure of information with respect to the Company's oil and gas activities in accordance with securities regulatory requirements. This information includes reserves data, which consists of the following:

- (i) proved, proved plus probable and proved plus probable plus possible oil reserves, estimated as at December 31, 2010 using forecast prices and costs; and
- (ii) the related estimated future net revenue.

McDaniel & Associates Consultants Ltd., an independent qualified reserves evaluator, has evaluated the Company's reserves data. The report of the independent qualified reserves evaluator will be filed with the securities regulatory authorities concurrently with this report.

The Reserves Committee of the Board of the Company has:

- a) reviewed the Company's procedures for providing information to the independent qualified reserves evaluator;
- b) met with the independent qualified reserves evaluator to determine whether any restrictions affected the ability of the independent qualified reserves evaluator to report without reservation; and
- c) reviewed the reserves data with management and the independent qualified reserves evaluator.

The Reserves Committee of the Board has reviewed the Company's procedures for assembling and reporting other information associated with oil and gas activities and has reviewed that information with management. The Board has, on the recommendation of the Reserves Committee, approved:

- a) the content and filing with securities regulatory authorities of the reserves data and other oil and gas information;
- b) the filing of the report of the independent qualified reserves evaluator on the reserves data; and
- c) the content and filing of this report.

Because the reserves data are based on judgments regarding future events, actual results will vary and the variations may be material. However, any variations should be consistent with the fact that reserves are categorized according to the probability of their recovery.

Signed

*“Edmund Shmoon”*

Edmund M. Shmoon, Chairman & Chief Executive Officer, Director

Signed

*“Memet Kont”*

Memet Kont, President & Chief Operating Officer, Director

Signed

*“Thomas Skupa”*

Thomas H. Skupa, Director

Signed

*“Kenneth Stephenson”*

Kenneth M. Stephenson, Director

February 28, 2011

## **SCHEDULE B: AUDIT COMMITTEE MANDATE**

### **CALVALLEY PETROLEUM INC. AUDIT COMMITTEE MANDATE**

#### **Purpose**

The Audit Committee (the "Committee") is a committee of the Board of Calvalley Petroleum Inc. (the "Corporation") to which the Board has delegated its responsibility for oversight of the nature and scope of the annual audit, management's reporting on internal accounting standards and practices, financial information and accounting systems and procedures, financial reporting and statements and recommending, for Board of Director approval, the audited financial statements and other mandatory disclosure releases containing financial information. The objectives of the Committee are as follows:

1. To ensure Directors meet their responsibilities (especially for accountability) in respect of the preparation and disclosure of the financial statements of the Corporation and related matters.
2. To provide effective communication between Directors and external auditors.
3. To enhance the external auditor's independence.
4. To increase the credibility and objectivity of financial reports.
5. To strengthen the role of the outside Directors by facilitating in-depth discussions between Directors on the Committee, management and external auditors.

#### **Membership of Committee**

1. The Committee shall be comprised of at least three (3) Directors of the Corporation, none of whom are members of management of the Corporation and all of whom are "independent" as such term is used in Multilateral Instrument 52-110 - Audit Committees ("MI 52-110").
2. The Board shall have the power to appoint the Committee Chairman, who shall be an unrelated Director.
3. All of the members of the Committee shall be "financially literate". The Board of the Corporation has adopted the definition for "financial literacy" used in MI 52-110.

#### **Meetings**

4. At all meetings of the Committee every question shall be decided by a majority of the votes cast. In case of an equality of votes, the Chairman of the meeting shall be entitled to a second or casting vote.
5. A quorum for meetings of the Committee shall be a majority of its members, and the rules for calling, holding, conducting and adjourning meetings of the Committee shall be the same as those governing the Board.
6. Meetings of the Committee should be scheduled to take place at least four times per year. Minutes of all meetings of the Committee shall be taken. The Chief

Financial Officer shall attend meetings of the Committee, unless otherwise excused from all or part of any such meeting by the Chairman.

7. The Committee shall forthwith report the results of meetings and reviews undertaken and any associated recommendations to the Board.
8. The Committee shall meet with the external auditor at least once per year (in connection with the preparation of the year end financial statements) and at such other times as the external auditor and the Audit Committee consider appropriate.

#### **Mandate and Responsibilities of Committee**

9. It is the responsibility of the Committee to oversee the work of the external auditors, including resolution of disagreements between management and the external auditors regarding financial reporting.
10. It is the responsibility of the Committee to satisfy itself on behalf of the Board with respect to Internal Control Systems:
  - identifying, monitoring and mitigating business risks; and
  - ensuring compliance with legal, ethical and regulatory requirements.
11. It is a primary responsibility of the Committee to review the annual financial statements of the Corporation prior to their submission to the Board for approval. The process should include but not be limited to:
  - reviewing changes in accounting principles, or in their application, which may have a material impact on the current or future years' financial statements;
  - reviewing significant accruals, reserves or other estimates such as the ceiling test calculation;
  - reviewing accounting treatment of unusual or non-recurring transactions;
  - ascertaining compliance with covenants under loan agreements;
  - reviewing disclosure requirements for commitments and contingencies;
  - reviewing adjustments raised by the external auditors, whether or not included in the financial statements;
  - reviewing unresolved differences between management and the external auditors; and
  - obtain explanations of significant variances with comparative reporting periods.

12. The Committee is to review the financial statements, prospectuses, management discussion and analysis (MD&A), annual information forms (AIF) and all public disclosure containing audited or unaudited financial information before release and prior to Board approval. The Committee must be satisfied that adequate procedures are in place for the review of the Corporation's disclosure of all other financial information and shall periodically assess the accuracy of those procedures.
13. With respect to managing, on behalf of the shareholders, the relationship between the external auditors and the Corporation the Committee shall:
  - recommend to the Board the nomination of the external auditors;
  - recommend to the Board the terms of engagement of the external auditor, including the compensation of the auditors and a confirmation that the external auditors shall report directly to the Committee;
  - when there is to be a change in auditors, review the issues related to the change and the information to be included in the required notice to securities regulators of such change;
  - review and approve any non-audit services to be provided by the external auditors' firm and consider the impact on the independence of the auditors; and
  - determine through inquiry if there are any related party transactions and ensure the nature and extent of such transactions are properly disclosed.
14. Review with external auditors (and internal auditor if one is appointed by the Corporation) their assessment of the internal controls of the Corporation, their written reports containing recommendations for improvement, and management's response and follow-up to any identified weaknesses. The Committee shall also review annually with the external auditors their plan for their audit and, upon completion of the audit, their reports upon the financial statements of the Corporation and its subsidiaries.
15. The Committee must pre-approve all non-audit services to be provided to the Corporation. by the external auditors. The Committee may delegate to one or more members the authority to pre-approve non-audit services, provided that the member report to the Committee at the next scheduled meeting such pre-approval and the member comply with such other procedures as may be established by the Committee from time to time.
16. The Committee shall review risk management policies and procedures of the Corporation (i.e. hedging, litigation and insurance).
17. The Committee shall establish a procedure for:
  - the receipt, retention and treatment of complaints received by the Corporation regarding accounting, internal accounting controls or auditing matters; and

- the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters.
18. The Committee shall review and approve the Corporation's hiring policies regarding employees and former employees of the present and former external auditors of the Corporation.
  19. The Committee shall have the authority to investigate any financial activity of the Corporation. All employees of the Corporation are to cooperate as requested by the Committee.
  20. The Committee may retain persons having special expertise and/or obtain independent professional advice to assist in filling their responsibilities at the expense of the Corporation without any further approval of the board.

## **SCHEDULE C: BOARD OF DIRECTORS MANDATE**

### **CALVALLEY PETROLEUM INC. BOARD OF DIRECTORS MANDATE**

#### **Purpose**

The principal role of the Board of Calvalley Petroleum Inc. (the "Company") is stewardship of the Company through the creation of shareholder value, including the protection and enhancement of the value of its assets, as the fundamental objective. The stewardship responsibility means that the Board oversees the conduct of the business and management, which is responsible for the day-to-day conduct of the business. The Board must assess and ensure systems are in place to manage the risks of the Company's business with the objective of preserving the Company's assets. The Board, through the Chief Executive Officer ("CEO"), sets the attitude and disposition of the Company towards compliance with applicable laws, environmental, safety and health policies, financial practices and reporting. In addition to its primary accountability to shareholders, the Board is also accountable to employees, government authorities, other stakeholders and the public.

#### **Primary Responsibilities**

The principal responsibilities of the Board, which are required to ensure the overall stewardship of the Company are as follows:

1. The Board must ensure that there are long-term goals in place and must adopt a strategic planning process. The CEO, with the approval of the Board, must establish long-term goals for the Company. The CEO formulates the Company's strategy, policies and proposed actions and presents them to the Board for approval. The Board brings objectivity and judgment to this process. The Board ultimately approves, on an annual basis, the strategic plan which takes into account, among other things, the opportunities and risks of the Company's business.
2. The Board must identify and have an understanding of the principal risks associated with the Company's businesses, and must ensure that appropriate systems are in place which effectively monitor and manage those risks.
3. The Board must ensure that processes are in place to enable it to monitor and measure management's, and in particular the CEO's, performance in achieving the Company's stated objectives. These processes should include appropriate training, development and succession planning of management.
4. To the extent feasible, the Board shall satisfy itself as to the integrity of the CEO and other executive officers and that the CEO and other executive officers create a culture of integrity throughout the Company.
5. The Board must ensure that the necessary internal controls and management systems are in place that effectively monitor the Company's operations and ensure compliance with applicable laws, regulations and policies.
6. The Board must monitor compliance with the Company's Code of Business Conduct and Ethics; and
7. The Board must ensure the Company has adopted a communication policy which effectively communicates with and receives feedback from shareholders. The Board must also ensure that the Company has appropriate processes in place to effectively communicate with employees, government authorities, other stakeholders and the public.

## **Non-Delegable Responsibilities**

Pursuant to the *Canada Business Corporations Act* (the “Act”), certain matters are considered to be of such importance, so as to warrant the attention of all Directors and, accordingly, the Act prescribes that the following matters either cannot be delegated or may only be delegated in a qualified or partial manner:

- the submission of items to shareholders for their approval.
- the filling of a vacancy among the directors or in the office of auditor.
- the appointment of additional directors.
- the issue of securities.
- the declaration of dividends.
- the purchase, redemption or other acquisition of the Company’s own shares.
- the payment of certain commissions prescribed by the Act.
- the approval of a management proxy circular.
- the approval of annual financial statements.
- the adoption, amendment or repeal of by-laws.
- the review and approval of
  - (1) the content and filing of the Company’s statement of reserves data and other oil and gas information;
  - (2) the filing of the report on reserves data by the Company’s Qualified Reserves Evaluator or Auditor; and
  - (3) the content and filing of the Company’s report of management and directors on oil and gas disclosure.

## **Customary Board Matters**

The following typifies matters customarily considered by the Board in fulfilling its responsibility for stewardship of the Company. The Board may determine it appropriate to delegate certain of these matters to committees of the Board:

- the appointment of officers, other than executive officers;
- adopting a process to consider the competencies and skills the Board, as a whole, should possess and assess the competencies and skills of each Board member and consider the appropriate size of the Board, with a view to facilitating effective decision-making;
- determining the remuneration of directors and auditors;
- reviewing and recommending to shareholders, changes to capital structure;
- approving the Company’s long term strategy and the annual capital expenditure plan of the Company and its subsidiaries and where appropriate any supplementary capital plan;
- approving banking, borrowing and investment policies;
- determining dividend policy;
- developing the Company’s approach to corporate governance including, without limitation, developing a set of corporate governance principles and guidelines;
- approving the holding, location and date of meetings of shareholders;
- appointment of members to committees of the Board and approving terms of reference for and the matters to be delegated to such committees;
- granting any waivers from the Company’s Code of Business Conduct and Ethics for the benefit of the Company’s directors or executive officers;
- granting and delegating authority to designated officers and employees including the authority to commit capital, open bank accounts, sign bank requisitions and sign contracts, documents and instruments in writing;
- determining the number of directors and recommending nominees for election by the shareholders;

- approving amendments to the Company's existing plans: Stock Option Plan, employee benefits plans, or such other plans as the Company approves from time to time;
- approving the acquisition or disposition of certain corporate assets; and
- appointing the Company's transfer agents and registrars.

### **Board Committees**

The Board has the authority to appoint a committee or committees of the Board and may delegate powers to such committees (with the exceptions prescribed by the Act). The matters to be delegated to committees of the Board and the constitution of such committees are assessed annually or more frequently as circumstances require. The following committees have been constituted:

1. The Board must ensure the Company has adopted a communication policy which effectively communicates with and receives feedback from shareholders. The Board must also ensure that the Company has appropriate processes in place to effectively communicate with employees, government authorities, other stakeholders and the public.
2. the Compensation Committee, to deal with the assessment of management and succession to key positions and compensation within the Company;
3. the Disclosure Committee, to deal with the Company's approach to disclosure and the promotion of compliance;
4. the Corporate Governance Committee, to deal with the Company's approach to corporate governance and the promotion of compliance; and
5. the Reserves Committee, to deal with matters relating to the Company's oil and gas reserves and related reporting.

### **Composition and Procedure**

The Board is elected annually by shareholders. The number of Directors to be elected at shareholders meetings is fixed by the by-laws. While the election of directors is ultimately determined by the shareholders, it is the policy of the Board that a majority of the Directors be independent (as defined under applicable stock exchange rules and securities laws).

The Chairman of the Board presides as Chair at all meetings of the Board and shareholders of the Company. The Corporate Secretary or, in the absence of the Corporate Secretary, an Assistant Corporate Secretary attends all meetings of the Board and shareholders and records the proceedings thereof. The Corporate Secretary prepares and keeps minutes and records of all meetings of the Board.

Meetings of the Board, including telephone conference meetings, are to be held at such time and place as the Chairman of the Board, or any two Directors, may determine. Notice of meetings shall be given to each Director in accordance with the by-laws. Meetings of the Board may be held without formal notice if all of the Directors are present and do not object to notice not having been given, or if those absent waive notice in any manner before or after the meeting.

Notice of meeting may be delivered personally, given by mail, facsimile or other electronic means of communication.

Any two members of the Board constitutes a quorum at any meeting.

Each Board member is expected to attend Board meetings and meetings of committees of which he or she is a member and to become familiar with deliberations and decisions as soon as possible after any missed meetings. In that regard, members of the Board are expected to

prepare for Board (and committee) meetings by reviewing meeting materials distributed to members of the Board, to the extent feasible, in advance of such meetings. Matters of a confidential or sensitive nature may be discussed at Board (or committee) meeting without advance distribution of meeting materials to members of the Board. It is expected that members of the Board will actively participate in determining and setting the long and short-term goals and interests of the Company.

In recognition of its independence, the Board shall regularly hold discussions without management present.

A resolution in writing signed by all the Directors entitled to vote on that resolution at a meeting of the Directors is as valid as if it had been passed at a meeting of the Directors. A copy of any such resolution in writing is kept with the minutes of the proceedings of the Directors.

At meetings of the Board, any matter requiring a resolution of the Directors is decided by a majority of the votes cast on the question; and in the case of an equality of votes, the Chair of the meeting is entitled to a second or casting vote.

The Board shall ensure that there is a process in place for annually evaluating the effectiveness of the Board, the committees of the Board and individual directors.

### **Compensation**

No Director, unless he or she is an officer of the Company, should receive remuneration from the Company other than compensation received in his or her capacity as a Director.