

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549  
**FORM 10-Q**

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2004

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-3793

**CANADA SOUTHERN PETROLEUM LTD.**

.....  
(Exact name of registrant as specified in its charter)

NOVA SCOTIA, CANADA

98-0085412

.....  
(State or other jurisdiction of  
incorporation or organization)

.....  
(I.R.S. Employer  
Identification No.)

#250, 706 - 7th Avenue, S.W., Calgary, Alberta, Canada

T2P 0Z1

.....  
(Address of principal executive offices)

.....  
(Zip Code)

(403) 269-7741

.....  
(Registrant's telephone number, including area code)

.....  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b - 2 of the Act). ☐ Yes ☒ No

Indicate the number of shares outstanding of the issuer's classes of common stock as of the latest practicable date:

Limited Voting Shares, par value \$1.00 (Canadian) per share 14,417,770 shares outstanding as of May 10, 2004.

**CANADA SOUTHERN PETROLEUM LTD.**

**FORM 10-Q**

**MARCH 31, 2004**

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**Unless otherwise indicated, all dollar figures set forth are expressed in Canadian currency.**

## PART I - FINANCIAL INFORMATION

### Item 1. Financial Statements

#### CANADA SOUTHERN PETROLEUM LTD.

##### CONSOLIDATED BALANCE SHEETS

(Expressed in Canadian dollars)  
(unaudited)

	<b>March 31, 2004 (unaudited)</b>	<b>December 31, 2003<sup>(1)</sup> <i>restated</i> (note 2)</b>
<b>Assets</b>		
Current assets		
Cash and cash equivalents (note 3)	<b>\$ 36,975,528</b>	\$ 49,082,386
Accounts receivable (note 4)	<b>3,669,762</b>	3,138,465
Other assets	<b>431,969</b>	400,643
Total current assets	<b>41,077,259</b>	52,621,494
 Oil and gas properties and equipment, net (full cost method)	 <b>9,944,856</b>	 9,420,903
 Total assets	 <b>\$ 51,022,115</b>	 \$ 62,042,397
 <b>Liabilities and Shareholders' Equity</b>		
Current liabilities		
Accounts payable	<b>\$ 1,102,998</b>	\$ 2,947,763
Accrued liabilities (note 5)	<b>586,702</b>	1,709,889
Income taxes payable	<b>-</b>	9,752,303
Total current liabilities	<b>1,689,700</b>	14,409,955
 Future income tax liability	 <b>2,672,864</b>	 2,221,864
Asset retirement obligations (note 6)	<b>2,496,769</b>	2,436,986
Total liabilities	<b>6,859,333</b>	19,068,805
 Contingencies (note 7)		
 Shareholders' Equity (note 8)		
Limited Voting Shares, par value \$1 per share		
Authorized –100,000,000 shares		
Outstanding –14,417,770 shares	<b>14,417,770</b>	14,417,770
Contributed surplus	<b>28,210,851</b>	28,177,451
Total capital	<b>42,628,621</b>	42,595,221
Retained earnings	<b>1,534,161</b>	378,371
Total shareholders' equity	<b>44,162,782</b>	42,973,592
Total liabilities and shareholders' equity	<b>\$ 51,022,115</b>	\$ 62,042,397

(1) The balance sheet at December 31, 2003 has been derived from  
the audited consolidated financial statements at that date.

See accompanying notes.

# CANADA SOUTHERN PETROLEUM LTD.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS (DEFICIT)

(Expressed in Canadian dollars)  
(unaudited)

	Three months ended March 31,	
	2004	2003 <i>restated</i> <i>(note 2)</i>
<b>Revenues:</b>		
Proceeds from carried interests	\$ 2,006,002	\$ 2,876,702
Natural gas sales	1,114,515	1,033,305
Oil and liquid sales	64,871	99,467
Interest and other income	284,133	132,816
Total revenues	<u>3,469,521</u>	<u>4,142,290</u>
<b>Costs and expenses:</b>		
General and administrative	602,591	397,363
Legal	50,319	146,594
Lease operating costs	223,500	482,508
Depletion, depreciation and amortization	761,000	535,390
Asset retirement obligations accretion expense	60,000	15,829
Stock option expense	33,400	5,775
Foreign exchange (gain) loss	(28,079)	203,905
Total costs and expenses	<u>1,702,731</u>	<u>1,787,364</u>
Income before income taxes	1,766,790	2,354,926
Income taxes (note 9)	(611,000)	(1,041,571)
<b>Net income</b>	<u>1,155,790</u>	<u>1,313,355</u>
Retained earnings (deficit) - beginning of period	378,371	(16,671,747)
Retained earnings (deficit) - end of period	<u>\$ 1,534,161</u>	<u>\$(15,358,392)</u>
<b>Net income per share:</b> (note 10)		
<b>Basic</b>	<u>\$0.08</u>	<u>\$0.09</u>
<b>Diluted</b>	<u>\$0.08</u>	<u>\$0.09</u>
Average number of shares outstanding:		
Basic	<u>14,417,770</u>	<u>14,417,770</u>
Diluted	<u>14,418,918</u>	<u>14,417,770</u>

See accompanying notes.

# CANADA SOUTHERN PETROLEUM LTD.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in Canadian dollars)  
(unaudited)

	Three months ended March 31,	
	2004	2003
		<i>restated</i> <i>(note 2)</i>
<b>Cash flows from operating activities:</b>		
Net income	\$ 1,155,790	\$ 1,313,355
Adjustments to reconcile net income to net cash provided from (used in) operating activities:		
Depletion depreciation, and amortization	761,000	535,390
Future income tax expense	451,000	491,571
Asset retirement obligations accretion expense	60,000	15,829
Asset retirement expenditures	(217)	(137,282)
Stock option expense	33,400	5,775
Funds provided from operations	2,460,973	2,224,638
Change in current assets and liabilities:		
Accounts receivable	(531,297)	(958,565)
Other assets	(31,326)	46,940
Accounts payable	(1,844,765)	33,757
Accrued liabilities	(1,123,187)	1,381,101
Income taxes payable	(9,752,303)	-
Net cash (used in) provided from operations	(10,821,905)	2,727,871
<b>Cash flows used in investing activities:</b>		
Additions to oil and gas properties	(1,284,953)	(539,122)
Net cash used in investing activities	(1,284,953)	(539,122)
<b>Cash flows from financing activities:</b>	-	-
(Decrease) increase in cash and cash equivalents	(12,106,858)	2,188,749
Cash and cash equivalents at the beginning of period	49,082,386	19,454,453
<b>Cash and cash equivalents at the end of period</b>	<b>\$ 36,975,528</b>	<b>\$ 21,643,202</b>

See accompanying notes.

## **Item 1.        Notes to Consolidated Financial Statements**

### **1.    Basis of presentation**

The accompanying unaudited condensed consolidated financial statements, including the accounts of Canada Southern Petroleum Ltd. and its wholly owned subsidiaries, Canpet Inc. and C.S. Petroleum Limited, have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). These financial statements have been prepared following the same accounting policies and methods of computation as the annual audited consolidated financial statements for the year ended December 31, 2003, except for those in note 2. The effect of differences between these principles and accounting principles generally accepted in the United States ("U.S. GAAP") is discussed in Note 11. These financial statements conform in all material respects with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. These financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

### **2.    Changes in accounting policies**

#### ***(a)    Asset retirement obligations***

Effective January 1, 2004 the Company retroactively adopted the Canadian Institute of Chartered Accountants ("CICA") new standard for accounting for asset retirement obligations. This standard requires that the fair value of the statutory, contractual or legal obligation associated with the retirement and reclamation of tangible long-lived assets be recorded when the obligation is incurred, with a corresponding increase to the carrying amount of the related assets. This corresponding increase to capitalized costs is amortized to earnings on a basis consistent with depreciation, depletion, and amortization of the underlying assets. Subsequent changes in the estimated fair value of the asset retirement obligations are capitalized and amortized over the remaining useful life of the underlying asset.

The asset retirement obligation liabilities are carried on the consolidated balance sheet at their discounted present value and are accreted over time for the change in their present value. This standard was adopted retroactively on January 1, 2004 and prior period amounts were restated.

#### ***(b)    Stock-based compensation***

The Company has adopted the Canadian accounting standard as outlined in the CICA Handbook section 3870, "Stock-based Compensation and Other Stock-based Payments", which requires the use of the fair value method for valuing stock option grants. Under this method, compensation cost attributable to share options granted to employees or directors is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration paid is recorded as an increase to total capital. This standard was adopted retroactively on January 1, 2004 and prior period amounts were restated. Pursuant to the transition rules, the expense recognized applies to stock options granted on or after January 1, 2002.

#### ***(c)    Full cost accounting***

The Company has adopted the new CICA Accounting Guideline AcG-16 "Oil and Gas Accounting – Full Cost". Under the new guideline, cash flows used in the ceiling test calculation are estimated using expected future product prices and costs. Prior to adopting this new standard, constant dollar pricing was used to test impairment. There is no impact on the Company's reported financial results as a result of adopting this guideline.

**Item 1. Notes to consolidated financial statements (cont'd)****2. Changes in accounting policies (cont'd)**

The adjustments required to the December 31, 2003 balance sheet to implement these changes in accounting are as follows:

	See Note	As previously reported	Adjustments	As restated
Oil and gas properties and equipment	2a	\$ 8,906,029	\$ 514,874	\$ 9,420,903
Future income tax liability	2a	2,096,000	125,864	2,221,864
Asset retirement obligations	2a	2,223,078	213,908	2,436,986
Contributed surplus	2b	27,271,833	905,618	28,177,451
Retained earnings	2a	1,108,887	175,102	
	2b		(905,618)	378,371

The adjustments to the income statement for the three months ended March 31, 2003 are as follows:

	See Note	As previously reported	Adjustments	As restated
Depletion, depreciation and amortization	2a	\$ 516,263	\$ 19,127	\$ 535,390
Future site restoration costs	2a	50,000	(50,000)	-
Asset retirement obligation accretion expense	2a	-	15,829	15,829
Stock option expense	2b	-	5,775	5,775
Income taxes	2a	1,035,000	6,571	1,041,571
Net income	2a,b	1,310,657	2,698	1,313,355
Net income per share				
Basic	2a,b	\$0.09	\$0.00	\$0.09
Diluted	2a,b	\$0.09	\$0.00	\$0.09

**3. Cash and cash equivalents**

Canada Southern considers all highly liquid short-term investments with maturities of three months or less at date of acquisition to be cash equivalents. Cash equivalents are carried at cost, which approximates market value due to their short term nature.

	March 31, 2004	December 31, 2003
Cash	\$ 153,356	\$ 164,036
Canadian marketable securities (Yield: 2004 – 2.3%, 2003 – 2.8%)	34,862,344	46,851,157
U.S. marketable securities (Yield: 2004 – 1.0%, 2003 -1.2%)	1,959,828	2,067,193
Total	<u>\$ 36,975,528</u>	<u>\$ 49,082,386</u>

**Item 1. Notes to consolidated financial statements (cont'd)****4. Accounts receivable**

Accounts receivable is comprised mainly of accounts from various industry partners in the Company's oil and gas properties as follows:

	<b>March 31, 2004</b>	<b>December 31, 2003</b>
Kotaneelee partners	<b>\$ 2,577,910</b>	\$ 2,083,278
Samson Canada Ltd.	<b>387,526</b>	401,517
Anadarko Canada	<b>92,261</b>	37,993
Others	<b>612,065</b>	615,677
<b>Total</b>	<b>\$ 3,669,762</b>	<b>\$ 3,138,465</b>

The Kotaneelee partners are comprised of BP Canada Energy Company, Devon Canada, Imperial Oil Resources, and ExxonMobil Canada Properties.

**5. Accrued liabilities**

Accrued liabilities are as follows:

	<b>March 31, 2004</b>	<b>December 31, 2003</b>
Contingent interests settlement	<b>\$ -</b>	\$ 1,000,000
Capital and operating costs	<b>164,763</b>	169,063
Royalties	<b>246,600</b>	355,800
Accounting and legal expenses	<b>100,440</b>	76,473
Audit fees	<b>26,018</b>	40,000
Independent reserve evaluator fees	<b>28,030</b>	36,200
Directors' compensation	<b>20,851</b>	32,353
<b>Total</b>	<b>\$ 586,702</b>	<b>\$ 1,709,889</b>

**6. Asset retirement obligations**

Details of asset retirement obligations for the period are as follows:

	<b>Three months ended March 31, 2004</b>	<b>Year ended December 31, 2003</b>
		<i>restated (see note 2)</i>
Balance - beginning of year	<b>\$ 2,436,986</b>	\$ 785,886
Asset retirement obligations accretion expense	<b>60,000</b>	285,000
Liabilities arising from the Kotaneelee settlement	<b>-</b>	1,538,000
Asset retirement expenditures	<b>(217)</b>	(171,900)
<b>Balance - end of period</b>	<b>\$ 2,496,769</b>	<b>2,436,986</b>

The total undiscounted amount of the cash flows required to settle the Company's asset retirement obligation is estimated to be \$3,940,000. The estimated cash flows have been discounted using credit adjusted risk free interest rates ranging from 7% to 11%. These payments are expected to be incurred between the years 2005 and 2022.



**Item 1.**      **Notes to consolidated financial statements (cont'd)**

**7. Contingencies**

*Settlement of Kotaneelee litigation*

On September 9, 2003, the parties in the litigation concerning the Kotaneelee gas field entered into a comprehensive Settlement Agreement. (For details of the litigation see Item 3 Legal Proceedings of the Company's Annual Report on Form 10-K dated March 27, 2003, as amended by the Company's Form 10-K/A dated April 30, 2003).

The settlement was finalized on October 3, 2003. Pursuant to the settlement there has been a complete abandonment of the litigation, including the claim that the defendants failed to fully develop the field.

In the fourth quarter of 2003, the Company realized a gross pre-income tax amount of \$22,727,000 in the settlement, which amount represents a complete settlement of the litigation, including a recovery of the wrongfully withheld gas processing fees and related interest. These proceeds constitute taxable income for Canadian income tax purposes upon receipt by the Company.

In connection with the settlement, Canada Southern acquired on October 31, 2003, from Perkins Holdings, Ltd. and Levcor International Inc., a 0.67% carried interest in Kotaneelee formerly held by Levcor, including the associated interest in the litigation.

Also in connection with the settlement, the Company agreed to be responsible for its share of abandonment and reclamation liabilities at the Kotaneelee field when they occur. It is estimated that the Company's 30.67% share of the abandonment liabilities will amount to approximately \$2,400,000 (undiscounted).

The settlement agreement does not include any understandings with or commitments by the working interest owners to further develop the Kotaneelee field beyond those mechanisms for doing so contained in the joint venture agreements.

*Contingent Interest Litigation*

In 1991 and 1997, the Company granted contingent interests in certain net recoveries from the Kotaneelee litigation. After the settlement with the defendants was agreed upon, the Company's Board of Directors established a committee comprised solely of directors with no direct or indirect personal interest in the matter of the contingent interests. This independent committee of directors, comprised of Messrs. Kanik, McGinity and Stewart, consulted with independent outside counsel with regard to what amounts, if any, were payable pursuant to the contingent interests.

In early October 2003, counsel to the independent committee advised each of the contingent interest grantees that the committee had concluded, based on advice of counsel, that there was no entitlement arising under such interests.

Mr. Arthur B. O'Donnell (a director of Canada Southern Petroleum Ltd. since 1997), a beneficial holder of a 0.333% contingent interest (derived from G&O'D Inc.), Mr. James R. Joyce, a beneficial holder of a 0.333% contingent interest (derived from G&O'D Inc.), and Murtha Cullina LLP (Mr. Timothy L. Largay, a partner of the firm, has been a director of Canada Southern Petroleum Ltd. since 1997), a grantee of a 1.00% contingent interest, had each notified counsel to the committee of their agreement with the committee's conclusion.

Prior to the conclusion of the independent committee that the contingent interest grantees had no entitlement arising under such interests, the Company had received communications from counsel representing the 2.0% contingent interest granted to C. Dean Reasoner asserting entitlements arising under such grants.

**Item 1. Notes to consolidated financial statements (cont'd)****7. Contingencies (cont'd)**

The following grantees, each of whom previously served as litigation counsel to the Company, had advised the Company that they disagreed with the committee's conclusion:

Robert J. Angerer, Sr., Esq.	2.00%
V. A. MacDonald, Esq.	0.75%
Peter McMahon, Esq.	1.00%

These grantees had asserted that the contingent interests applied to the withheld processing fees, production revenues from the field, and other alleged recoveries which could total more than \$200,000,000. The Company did not accept their position.

The Company was advised that certain contingent interest grantees had retained legal counsel to advise them on and pursue the matter with the Company.

In March 2004, in order to avoid a potentially prolonged, expensive and distracting litigation, the Company reached an agreement for an all-inclusive settlement with certain parties, including a former director and former litigation counsel to the Company, who were asserting claims of entitlement against the Company's net recoveries in the Kotaneelee litigation. Under the terms of the settlement, which had been accrued in the Company's fourth quarter 2003 financial results, Canada Southern paid these parties a total of \$1,000,000 in return for a general release from the parties asserting the claims and an agreement by the Company not to seek an adjustment in the prior payments for professional services made to prior litigation counsel.

The independent committee of the Board, created to consider the matter of the contingent interests, remains of the view that there should be no entitlements under the contingent interest grants. However, after lengthy consideration of the matter, involving continuous participation by outside counsel retained by the independent committee for this purpose, the independent committee reluctantly recommended that the Board of Directors approve the settlement summarized above. It was the view of the independent committee and the Board of Directors that, on balance, the shareholders are better served by the Company focusing its human and financial resources on strategically repositioning Canada Southern rather than enduring the distraction of a potentially prolonged and expensive litigation, the ultimate outcome of which could not be known with certainty.

**8. Limited voting shares and stock options****Summary of Options Outstanding at March 31, 2004**

<u>Years granted</u>	<u>Expiration Dates</u>	<u>Total</u>	<u>Exercisable</u>	<u>Option Prices</u>
2001	Nov 2006	45,000	30,000	\$ 6.81
2002	Jan 2007	100,000	100,000	\$ 7.53
2002	Apr 2007	50,000	50,000	\$ 6.81
2003	Jun 2008	50,000	50,000	\$ 6.58
2003	Dec 2008	30,000	-	\$ 6.97
2004	Mar 2009	30,000	-	\$ 6.89
Total – March 31, 2004		<u>305,000</u>	<u>230,000</u>	Average \$7.02
<u>Options Reserved for Future Grants</u>		<u>592,834</u>		

On January 28, 2004, 322,700 previously granted stock options, with an exercise price of \$7.00 per share, expired without exercise.

**Item 1. Notes to consolidated financial statements (cont'd)****8. Limited voting shares and stock options (cont'd)**

During March 2004, an employee of the Company was granted a five year option to purchase 30,000 shares at \$6.89 per share. The options vest over a two year period. On April 1, 2004, the Company's President and Chief Executive Officer was granted a five year option to purchase 100,000 shares at \$6.21 per share. One half of these options vest on April 1, 2005, with the remaining options vesting on April 1, 2006.

*Stock option expense*

Canada Southern accounts for its stock options using the fair value method. Under this method, the fair value of the options is amortized as additional compensation expense over the vesting period. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model. Option valuation models require the input of highly subjective assumptions including the expected stock price volatility. All of the valuations assumed no expected dividend. The assumptions used in the Black-Scholes model were: risk free interest rates ranging from 3.35% to 4.40%, expected volatilities ranging from 0.600 to 0.631 and expected life of 5 years.

Under the Black-Scholes option pricing model, the average fair value of the stock options issued in the years 2002 and 2003 were \$3.98 and \$2.25, respectively.

**9. Income taxes**

At March 31, 2004, the Company had no unused net operating losses for Canadian income tax purposes which are available to be carried forward to future periods. The components of income tax for the three month periods ended March 31, 2004 and 2003 are as follows:

	<b>Three months ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
		<i>restated</i>
Current income tax	<b>\$ 160,000</b>	\$ 550,000
Future income tax <sup>(1)</sup>	<b>451,000</b>	491,571
Total	<b>\$ 611,000</b>	<b>\$ 1,041,571</b>
Cash taxes paid	<b>\$ 9,943,000</b>	<b>\$ 35,000</b>

(1) On March 31, 2004, the Alberta government substantively enacted the income tax rate reduction announced in February 2004, which reduced the first quarter 2004 provision by \$26,400.

**10. Per share amounts**

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year.

The Company uses the treasury stock method to determine the dilutive effect of stock option and other dilutive instruments. Under the treasury stock method, only "in the money" dilutive instruments impact the diluted calculations in computing diluted earnings per share.

In computing diluted earnings per share, 1,148 (2003 - 0) shares were added to the 14,417,770 (2003 - 14,417,770) basic weighted average number of shares outstanding during the three month periods ended March 31, 2004 and 2003.

**Item 1. Notes to consolidated financial statements (cont'd)**

**11. U.S. GAAP differences**

The reconciliation of net income between Canadian and U.S. GAAP is summarized in the table below:

	Three months ended March 31,	
	2004	2003
Net income - Canadian GAAP	<b>\$1,155,790</b>	\$1,313,355
Stock option expense	-	5,775
Future income taxes (b)	<b>(26,400)</b>	-
Cumulative effect of change in accounting principle	-	68,231
Net income - U.S. GAAP	<b>1,129,390</b>	1,387,361
Change in value of available for sale securities (a)	<b>9,318</b>	46,283
Other comprehensive income	<b>\$1,138,708</b>	\$1,433,644
U.S. GAAP - net income per share		
Basic	<b>\$0.08</b>	\$0.10
Diluted	<b>\$0.08</b>	\$0.10
Average number of shares outstanding:		
Basic	<b>14,417,770</b>	14,417,770
Diluted	<b>14,418,918</b>	14,417,770

The balance sheet information for the Canadian and U.S. GAAP differences is summarized in the table below:

Balance sheet information

	March 31, 2004		Restated December 31, 2003	
	Canadian GAAP	U.S. GAAP	Canadian GAAP	U.S. GAAP
Current assets (a)	<b>\$ 41,077,259</b>	<b>\$ 41,172,175</b>	\$ 52,621,494	\$ 52,704,463
Oil and gas properties and equipment	<b>9,944,856</b>	<b>9,944,856</b>	9,420,903	9,420,903
	<b>\$ 51,022,115</b>	<b>\$ 51,117,031</b>	\$ 62,042,397	\$ 62,125,366
Current liabilities	<b>\$ 1,689,700</b>	<b>\$ 1,689,700</b>	\$ 14,409,955	\$ 14,409,955
Future income tax liability (a)(b)	<b>2,672,864</b>	<b>2,707,288</b>	2,221,864	2,227,260
Asset retirement obligations	<b>2,496,769</b>	<b>2,496,769</b>	2,436,986	2,436,986
Share capital (c)	<b>42,628,621</b>	<b>41,722,823</b>	42,595,221	41,689,423
Retained earnings (b)(c)	<b>1,534,161</b>	<b>2,413,559</b>	378,371	1,284,169
Accumulated other comprehensive income (a)	-	<b>86,892</b>	-	77,573
	<b>\$ 51,022,115</b>	<b>\$ 51,117,031</b>	\$ 62,042,397	\$ 62,125,366

*(a) Other comprehensive income*

Classifications within other comprehensive income relate to unrealized gains (losses) on certain investments in equity securities. During 1998, the Company wrote down the value of its interest in the Tapia Canyon, California heavy oil project to a nominal value. During August 1999, the project was sold and the Company received shares of stock in the purchaser. The purchaser has become a public company (Sefton Resources, Inc), which is listed on the London Stock Exchange (trading symbol "SER"). At March 31, 2004,

**Item 1.**      **Notes to consolidated financial statements (cont'd)**

**11. U.S. GAAP differences (cont'd)**

the Company owned approximately 1% of Sefton Resources, Inc. ("Sefton") with a fair market value of \$94,916 (December 31, 2003 - \$82,969) and a carrying value of \$1.00.

Under U.S. GAAP, the Sefton shares would be classified as available-for-sale securities and recorded at fair value at March 31, 2004. This would result in other comprehensive income for the three month periods ended March 31, 2004 and 2003. In addition, the balance sheet would reflect Marketable Securities in the amount of \$94,916 (December 31, 2003 - \$82,969) with a corresponding credit to Shareholders' Equity - Accumulated other comprehensive income in the same amount.

*(b) Future income taxes*

Under Canadian GAAP, the benefits of substantively enacted income tax rate reductions can be recorded, however under FASB 109 the benefits attributable to income tax rate changes can only be recorded when enacted. As at March 31, 2004, U.S. GAAP requires the recognition of an additional \$26,400 of future income tax expense and liability.

*(c) Stock-based compensation*

For U.S. GAAP reporting purposes, the Company has elected to adopt the fair value expense recognition provisions of FAS 123 "Accounting for Stock-based Compensation" and will report using the modified prospective method. This method provides prospective expense recognition for all new awards and the unvested portion of awards granted subsequent to January 1, 1995. As at March 31, 2004, U.S. GAAP requires the recognition of a \$905,798 increase in retained earnings and a corresponding decrease in the contributed surplus account.

**12. Subsequent event**

On April 6, 2004, Canada Southern settled what it had previously referred to as the "withheld revenue issue." In 2000, the operator of the Buick Creek, Wargen and Clarke Lake areas in British Columbia withheld approximately \$1,000,000 in payments from the carried interest account to recover an amount claimed to have been overpaid to Canada Southern in prior years. Canada Southern disagreed with the operator's position.

In full settlement of this issue, Canada Southern received \$300,000. In connection with the settlement, Canada Southern was also recognized as an owner of certain items that were previously charged to the carried interest account. The Company became recognized as a proprietary owner, and received copies of, approximately 183 km (114 miles) of 2-D seismic data in the areas of Buick Creek, Wargen and Peejay of N.E. British Columbia. Canada Southern also became recognized as an 11.5% working interest owner in the pooled salt water disposal facilities at Clarke Lake.

Further, in connection with the settlement, Canada Southern expended \$131,000 to acquire an interest in the pipeline infrastructure at Clarke Lake, and paid salt water disposal operating costs of \$6,000 for the period from January 7, 2001 to December 31, 2003.

During the second quarter ending June 30, 2004, Canada Southern will recognize the \$300,000 cash component of the settlement as revenue and record the \$131,000 acquisition of the pipeline infrastructure. As the salt water disposal facility and the seismic were previously charged to the carried interest account no accounting recognition of those components is required.

**Item 1.**            **Supplementary Oil and Gas Data**

<b><u>Total Sales Volumes (before royalties)</u></b>	<b>Three month periods ended March 31,</b>			
	<b>2004</b>	<b>2003</b>	<b>Change</b>	<b>% Change</b>
Carried interests (mcf)	<b>477,476</b>	659,999	(182,523)	(28%)
Carried interests (bbls)	<b>42</b>	37	5	14%
Natural gas (mcf)	<b>204,105</b>	192,691	11,414	6%
Oil and liquids (bbls)	<b>2,250</b>	2,711	(461)	(17%)
boe (6 mcf = 1 boe)	<b>115,889</b>	144,863	(28,974)	(20%)
boe per day	<b>1,274</b>	1,610	(336)	(20%)
mcfe (1 bbl = 6 mcfe)	<b>695,333</b>	869,178	(173,845)	(20%)
mcfe per day	<b>7,641</b>	9,658	(2,017)	(20%)

**Sales mix:**

Natural gas (mcf)	<b>98%</b>	98%	-	0%
Oil and natural gas liquids (mcfe)	<b>2%</b>	2%	-	0%

**Netback analysis for carried interest sales:**

Carried interests (per mcfe)				
Sales	<b>\$5.85</b>	\$ 5.89	(.04)	(1%)
Royalties	<b>(.77)</b>	(.84)	.07	(8%)
Transportation	<b>(.55)</b>	(.38)	(.17)	45%
Net Sales	<b>4.53</b>	4.67	(.14)	(3%)
Lease operating expenses	<b>(.32)</b>	(.31)	(.01)	3%
Carried interest capital	<b>(.01)</b>	-	(.01)	-
Field netback	<b>\$4.20</b>	\$ 4.36	(.16)	(4%)

**Netback analysis for working and royalty interest sales:**

Working and royalty interests (per mcfe)				
Sales	<b>\$5.74</b>	\$ 7.45	(1.71)	(23%)
Royalties	<b>(.32)</b>	(2.03)	1.71	84%
Net Sales	<b>5.42</b>	5.42	-	-
Lease operating expenses	<b>(1.03)</b>	(2.31)	1.28	(55%)
Field netback	<b>\$4.39</b>	\$ 3.11	1.28	41%

**Definition of Terms**

boe = barrel of oil equivalent

mcf = thousand cubic feet of natural gas

mcfe = thousand cubic feet equivalent

bbl = barrel of oil

**Item 2.**                    **Management's Discussion and Analysis of Financial Condition and Results of Operations**

Statements included in Management's Discussion and Analysis of Financial Condition and Results of Operations which are not historical in nature are intended to be, and are hereby identified as, "forward looking statements" for purposes of the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995. Canada Southern cautions readers that forward looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated in the forward looking statements. Among these risks and uncertainties are uncertainties as to the pricing, production levels and costs from the properties in which Canada Southern has interests, the extent of the recoverable reserves at those properties. The Company undertakes no obligation to update or revise forward looking statements, whether as a result of new information, future events, or otherwise. The Company does caution, however, that results in 2004 will be significantly lower than in 2003, which were favorably affected by settlement of the Kotaneelee litigation.

**Results of Operations**

*Three months ended March 31, 2004 vs. March 31, 2003*

A comparison of revenues, costs and expenses, net income and earnings per share for the first quarter of 2004 and the first quarter of 2003 is as follows:

	<b>Three months ended March 31,</b>		
	<b>2004</b>	<b>2003</b>	<b>Net Change</b>
		<i>restated<sup>(1)</sup></i>	
Revenues	<b>\$ 3,469,521</b>	\$ 4,142,290	\$ (672,769)
Costs and expenses	<b>(1,702,731)</b>	(1,787,364)	84,633
Income tax provision	<b>(611,000)</b>	(1,041,571)	430,571
Net income	<b><u>\$ 1,155,790</u></b>	<u>\$ 1,313,355</u>	<u>\$ (157,565)</u>
Net income per share:			
Basic	<b><u>\$0.08</u></b>	<u>\$0.09</u>	<u>\$(0.01)</u>
Diluted	<b><u>\$0.08</u></b>	<u>\$0.09</u>	<u>\$(0.01)</u>

(1) Certain figures relating to the three month period ending March 31, 2003 have been restated to reflect the adoption of certain accounting policies, as set out in note 2 to the interim consolidated financial statements.

Canada Southern receives its revenue from the production and sale of natural gas, natural gas liquids and crude oil from both carried and working interests. During the first quarter of 2004, the majority of the Company's revenue was from its carried interest position in the Kotaneelee field. Effective May 1, 2004, the Company converted its 30.67% carried interest in the Kotaneelee field to a corresponding 30.67% working interest. As such, future periods will reflect this change by showing substantially decreased carried interest revenues along with an offsetting increase in working interest revenues and costs.

**Proceeds from carried interests decreased 30% to \$2,006,000 during the first quarter of 2004** from \$2,877,000 in the first quarter of 2003. The following is a comparison of the proceeds from carried interests for the periods indicated:

	<b>Three months ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
Kotaneelee gas field	<b>\$2,004,000</b>	\$2,875,000
Other properties	<b>2,000</b>	2,000
Total	<b><u>\$2,006,000</u></b>	<u>\$2,877,000</u>

**Item 2.                    Management's Discussion and Analysis of Financial Condition and Results of Operations (Cont'd)**

*Three months ended March 31, 2004 vs. March 31, 2003 (Cont'd)*

Because of the uncertainties as to production rates, natural gas prices and future capital expenditures, Canada Southern is unable to accurately predict the amount of future net production proceeds that it may receive from the fields.

Production from the Kotaneelee field during the three months ended March 31, 2004, compared to 2003 is as follows:

Month	Gas Production		Water Production	
	<b>2004 (Mmcf/d)</b>	2003 (Mmcf/d)	<b>2004 (Bbls/d)</b>	2003 (Bbls/d)
January	<b>21.3</b>	30.8	<b>1,641</b>	1,336
February	<b>21.0</b>	30.6	<b>1,685</b>	1,434
March	<b>20.4</b>	29.3	<b>1,723</b>	1,417

Individual Kotaneelee well production for the month of March 2004 was 7.4 Mmcf per day from the B-38 well and 13.0 Mmcf per day from the I-48 well (production in March 2003 – B-38 was 13.2 Mmcf per day and the I-48 was 16.1 Mmcf per day).

Natural gas sales from the Kotaneelee field are approximately 78% of total monthly production due to shrinkage and fuel gas requirements.

Canada Southern's share of natural gas sales volumes decreased by 28% during the first quarter of 2004 from the first quarter of 2003 (from 659,999 mcf to 477,476 mcf respectively), mainly due to production declines. During the same period, average natural gas prices received for carried interest volumes remained flat. Operating and capital costs decreased by 23% to \$160,000 in the first quarter of 2004 as compared to \$208,000 in the first quarter of 2003.

Water production has increased since 2001. The operator improved the water handling capabilities of the surface equipment during the first quarter of 2002. Gross water production for the month of March 2004 was 1,502 bbls per day from the B-38 well and 221 bbls per day from the I-48 well (production in March 2003 – B-38 was 1,292 bbls per day and the I-48 was 125 bbls per day). Water production continues to increase and water handling capacity continues to be a concern. Natural gas production continues to decline as the reservoir pressure declines. Water production will at some point become a constraining factor on gas production. The Company is not able to predict with certainty the remaining economic life of the existing producing wells, their associated production profiles and the extent to which these wells will be able to access proven developed reserves.

During the year 2000, the operator of the carried interest properties at Buick Creek, Wargen and Clarke Lake withheld approximately \$1,081,000 in payments from the carried interest account to recover an amount claimed to have been overpaid to Canada Southern in prior years. Canada Southern disputed the operator's position and on April 6, 2004, reached an agreement with the operator. In full settlement of this issue, Canada Southern received \$300,000. In connection with the settlement, Canada Southern was also recognized as an owner of certain items that were previously charged to the carried interest account. The Company became recognized as a proprietary owner, and received copies of, approximately 183 km (114 miles) of 2-D seismic data in the areas of Buick Creek, Wargen and Peejay of N.E. British Columbia. Canada Southern also became recognized as an 11.5% working interest owner in the pooled salt water disposal facilities at Clarke Lake.

Further, in connection with the settlement, Canada Southern expended \$131,000 to acquire an interest in the pipeline infrastructure at Clarke Lake, and paid salt water disposal operating costs of \$6,000 for the period from January 7, 2001 to December 31, 2003.



**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Cont'd)**

*Three months ended March 31, 2004 vs. March 31, 2003 (Cont'd)*

During the second quarter ending June 30, 2004, Canada Southern will recognize the \$300,000 cash component of the settlement as revenue and record the \$131,000 acquisition of the pipeline infrastructure. As the salt water disposal facility and the seismic were previously charged to the carried interest account no accounting recognition of those components is required.

The volumes in thousand cubic feet (mcf) and barrels (bbls) (before deducting royalties) and the average price of natural gas per mcf and liquids per bbl sold during the periods indicated were as follows:

<b>Carried Interests</b>						
<b>Three months ended March 31,</b>						
	<b>2004</b>			<b>2003</b>		
	<b>Average</b>			<b>Average</b>		
	<b>price</b>			<b>price</b>		
	<b>per mcf/bbl</b>	<b>Total</b>		<b>per mcf/bbl</b>	<b>Total</b>	
	<b>mcf/bbls</b>			<b>mcf/bbls</b>		
Gas sales (mcf)	<b>477,476</b>	<b>\$ 5.85</b>	<b>\$2,794,000</b>	659,999	\$ 5.89	\$3,887,000
Liquids (bbls)	<b>42</b>	<b>40.55</b>	<b>2,000</b>	37	\$ 49.19	2,000
Transportation			<b>(264,000)</b>			(248,000)
Royalty expense			<b>(366,000)</b>			(556,000)
Operating costs			<b>(155,000)</b>			(207,000)
Capital costs			<b>(5,000)</b>			(1,000)
Total			<b>\$ 2,006,000</b>			<b>\$ 2,877,000</b>

**Natural gas revenue from working and royalty interest properties increased 8% to \$1,115,000 in the first quarter of 2004** from \$1,033,000 in the first quarter of 2003. There was a 7% decrease in the working interest volumes sold and a 23% decrease in the average sales price. Natural gas sales include royalty income, which increased by 174% from \$69,000 to \$189,000. Royalty volumes sold increased by 280% and the natural gas royalty sales price decreased 28% when compared with the first quarter of 2003. Natural gas royalty expense was significantly lower in the first quarter of 2004, as compared to the first quarter of last year, due to a change in an accounting estimate for a prior period of approximately \$145,000.

Working interest and royalty volumes in thousand cubic feet (mcf) (before deducting royalties) and the average price of natural gas per mcf sold during the periods indicated were as follows:

<b>Working and Royalty Interests</b>						
<b>Three months ended March 31,</b>						
	<b>2004</b>			<b>2003</b>		
	<b>Average</b>			<b>Average</b>		
	<b>price</b>			<b>price</b>		
	<b>per mcf</b>	<b>Total</b>		<b>per mcf</b>	<b>Total</b>	
	<b>mcf</b>			<b>mcf</b>		
Natural gas sales	<b>170,393</b>	<b>\$5.73</b>	<b>\$ 976,000</b>	183,821	\$7.39	\$1,359,000
Royalty income	<b>33,712</b>	<b>\$5.60</b>	<b>189,000</b>	8,870	\$7.78	69,000
Royalty expense	-		<b>(50,000)</b>	-		(395,000)
Total	<b>204,105</b>		<b>\$1,115,000</b>	192,691		<b>\$1,033,000</b>

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Cont'd)**

*Three months ended March 31, 2004 vs. March 31, 2003 (Cont'd)*

**Oil and natural gas liquid sales from working and royalty interests decreased by 35% in the first quarter of 2004 to \$65,000** compared to \$99,000 in the first quarter of 2003. The majority of the Company's liquids sales are derived from natural gas liquids. Liquid volumes in barrels (bbls) (before deducting royalties) and the average price per barrel sold during the periods indicated were as follows:

<b>Working and Royalty Interests</b>						
<b>Three months ended March 31,</b>						
	<b>2004</b>			<b>2003</b>		
	<b>bbls</b>	<b>Average price per bbl</b>	<b>Total</b>	<b>bbl</b>	<b>Average price per bbl</b>	<b>Total</b>
Natural gas liquid sales	<b>2,147</b>	<b>\$37.28</b>	<b>\$80,000</b>	2,685	\$47.62	\$ 128,000
Royalty income	<b>103</b>	<b>\$32.61</b>	<b>3,000</b>	26	\$40.04	1,000
Royalty expense	-		<b>(18,000)</b>	-		(30,000)
Total	<b>2,250</b>		<b>\$65,000</b>	<b>2,711</b>		<b>\$ 99,000</b>

**Interest and other income increased 114% in the first quarter of 2004 from \$133,000 in the first quarter of 2003 to \$284,000** as additional funds were available for investment after receiving the proceeds from the settlement of the Kotaneelee litigation in the fourth quarter of 2003. Due to the payment of approximately \$9,843,000 in income taxes in the month of February 2004 and the decreases in interest rates experienced, interest income is anticipated to be lower in future periods.

**General and administrative costs increased 52% in the first quarter of 2004 to \$603,000** from \$397,000 in the first quarter of 2003 primarily because of increases in directors' fees and expenses, consultants' expenses and insurance expense. Board of Directors' fees and Chairman fees were increased effective April 1, 2003 and July 1, 2003, respectively. Consultants' fees were higher in the first quarter of 2004 as a result of the higher operational activity level compared to the same time period in 2003. No general and administrative expenses were capitalized during the period.

A comparative summary of general and administrative costs grouped by major category is as follows:

<b>Three months ended March 31,</b>		
	<b>2004</b>	<b>2003</b>
Consultants	<b>\$ 156,000</b>	\$ 86,000
Salaries and benefits	<b>64,000</b>	53,000
Shareholder communications	<b>71,000</b>	53,000
Insurance expense	<b>96,000</b>	65,000
Directors' fees and expenses	<b>114,000</b>	49,000
Audit and professional services	<b>30,000</b>	48,000
Other	<b>72,000</b>	43,000
Total	<b>\$603,000</b>	<b>\$397,000</b>

**Legal expenses decreased 66% during the first quarter of 2004 to \$50,000** from \$147,000 during the first quarter of 2003. Legal work decreased significantly, year over year, given the settlement of the Kotaneelee litigation in early September 2003. While legal costs related to the litigation have decreased due to the Kotaneelee settlement, new disclosure and corporate governance regulations have been adopted in both Canada and the United States, and are expected to contribute to increased legal expenses during the remainder of the year.

**Item 2.**                    **Management's Discussion and Analysis of Financial**  
**Condition and Results of Operations (Cont'd)**

*Three months ended March 31, 2004 vs. March 31, 2003 (Cont'd)*

**Lease operating costs decreased 54% from \$483,000 in the first quarter of 2003 to \$224,000 in the first quarter of 2004.** Lease operating expenses were abnormally high in the first quarter last year as the Company had recognized the liability for estimated facility operating costs at Buick Creek which resulted from the conversion to a working interest effective January 1, 2001.

**Depletion, depreciation and amortization expense increased 47% in the first quarter of 2004 to \$761,000** from \$516,000 in the first quarter of 2003. The increased depletion rate is mainly due to the capital expenditures incurred during the fourth quarter of 2003 and the first quarter of 2004 without corresponding increases in proven reserves.

**Future site restoration costs increased by 71% to \$60,000 in the first quarter of 2004** compared with the restated amount of \$35,000 in the first quarter of 2003. The increase is mainly due to the addition of liabilities resulting from the settlement of the Kotaneelee litigation. In connection with the settlement, the Company agreed to be responsible for its share of abandonment and reclamation liabilities at the Kotaneelee field when they occur. It is estimated that the Company's 30.67% share of the abandonment liabilities will amount to approximately \$2,400,000.

**A foreign exchange gain of \$28,000 was recorded in the first quarter of 2004**, compared to a loss of \$204,000 in the first quarter of 2003 on the Company's U.S. dollar investments. The continued strength of the U.S. dollar compared to the Canadian dollar during the first quarter of 2004 resulted in the gain. With the relative volatility between the U.S. and Canadian dollar, the Company expects to record further foreign exchange losses or gains during the year. The value of the Canadian dollar was U.S. \$.7727 at December 31, 2003 compared to U.S. \$.7648 at March 31, 2004.

**An income tax provision of \$611,000 was recorded in the first quarter of 2004** compared to an income tax provision, as restated, of \$1,042,000 during the first quarter of 2003. During the first quarter of 2004, the Company's effective tax rate was 34.6% as compared to 44% during the first quarter of 2003. Although the Company's statutory Canadian corporate tax rate is approximately 40%, the majority (75%) of the decrease from the statutory tax rate is due to federal and provincial income tax rate reductions.

**Liquidity and Capital Resources**

At March 31, 2004, Canada Southern had \$36,975,528 of cash and cash equivalents. These funds are expected to be used for general corporate purposes including exploration and development activities.

The oil and gas business is inherently risky and capital intensive and can require significant capital and cash resources to expand and develop the business.

Net cash flow used in operations during the first three months of 2004 was \$10,822,000 compared to the net cash flow provided from operations of \$2,728,000 during the first three months of 2003.

Increase in income from operations	\$ 2,461,000
Net changes in accounts receivable and other	(563,000)
Net changes in current liabilities	(12,720,000)
Decrease in net cash provided by operations	<u>\$ (10,822,000)</u>

In connection with the receipt of taxable proceeds from the settlement of the Kotaneelee litigation, the Company paid \$9,843,000 of cash income tax during the first quarter of 2004.

**Item 2.**            **Management's Discussion and Analysis of Financial Condition and Results of Operations (Cont'd)**

**Liquidity and Capital Resources (Cont'd)**

Canada Southern's current cash flow from oil and gas operations is mainly derived from the Kotaneelee field. Net field level receipts from Kotaneelee represented approximately 68% of the Company's total net field receipts for the three months ended March 31, 2004, compared to 82% in the same period of 2003.

The Kotaneelee property continues to experience an increase in water production, and an associated decrease in gas production. There is a possibility that Canada Southern's cash flow from Kotaneelee could either be significantly reduced or terminated at any time in the future.

Further development of the Kotaneelee field may assist with the recovery of the existing remaining reserves, and as well, identify additional reserves. However, future development of Kotaneelee is highly risky due to the complexity and depth of the producing formation and the costs of drilling.

Effective May 1, 2004, Canada Southern converted from a 30.67% carried interest in the Kotaneelee gas field to a 30.67% working interest. On May 3, 2004, the Company was served by the field operator with a notice to drill a development well in the third quarter of 2004. The operator has estimated that the gross costs to drill, complete and equip the proposed well will be approximately \$20 million, of which Canada Southern's share, should it elect to participate to its 30.67% working interest, would be approximately \$6 million. It is estimated that the well's drilling and completion will take approximately 6 months. Canada Southern has been advised that if this proposed well is successful, production would not likely start until early next year.

Canada Southern has been advised that holders of a significant working interest in the Kotaneelee field will not be participating in the proposed well. Canada Southern is currently reviewing its participation options regarding this well. No assurances can be given that the remaining working interest owners will proceed with the proposed well or, if the well is proceeded with, whether Canada Southern will participate.

The Company is evaluating the existing developed reserves at Kotaneelee and further development opportunities on the lease, including the proposed development well.

The Company's northeast British Columbia properties are not as risky as Kotaneelee, but cannot be considered low risk due to depth of drilling, surface access, and related costs.

To create a more balanced portfolio of risk opportunities the Company is seeking to acquire some low risk properties. In the second quarter of 2003, Canada Southern acquired the mineral rights to approximately 10 contiguous sections of 100% interest land in the 40 Mile Coulee area of southern Alberta. To prove the technical concept of this lower risk, shallow natural gas area, the Company drilled and cased 3 exploration wells during October and November 2003. Due to the lack of pipeline infrastructure in the area, these wells are currently considered uneconomic; however, the Company is also looking at deeper, more attractive horizons on these lands. Depending on the results of any new wells that may be drilled, the Company would consider constructing the appropriate facility and pipeline infrastructure to bring production on-stream.

Canada Southern is currently performing technical evaluation of its petroleum and natural gas lease holdings in the Siphon and Mike/Hazel areas of northeast British Columbia. The Company drilled and cased a 100% working interest gas well at Siphon in late 2003. The well was completed in the first quarter of 2004 and is currently awaiting testing. Canada Southern has also completed a 25 sq. mile proprietary 3-D seismic program at Mike/Hazel and the geophysical interpretation is expected to be completed during the second quarter of this year. The Company may undertake drilling in 2004 at both areas depending upon the results of the geophysical and geological evaluations and economic analysis.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Cont'd)**

**Liquidity and Capital Resources (Cont'd)**

During the three months ended March 31, 2004, Canada Southern expended \$1,285,000 on capital additions. During the remainder of 2004, further capital expenditures for land, seismic, drilling, workovers, equipment, and other activities are expected to range from \$8,700,000 to \$18,700,000 with the greatest uncertainties being (i) whether or not the proposed development well at Kotaneelee proceeds and (ii) if it proceeds, at what level Canada Southern elects to participate. A summary of capital expenditures for the three months ended March 31, 2004, by area, is as follows:

Property name	Land	Seismic	Drilling	Completions	Facilities/ equipment	Total
Mike/Hazel	\$ 4,215	\$ 600,248	\$ -	\$ -	\$ -	\$ 604,463
Siphon	260,958	4,914	(8,636)	226,346	-	483,582
Buick Creek	1,676	-	107,356	-	-	109,032
40 Mile Coulee	9,100	14,058	-	-	-	23,158
Others	2,320	56,132	-	5,649	617	64,718
Total	<u>\$ 278,269</u>	<u>\$ 675,352</u>	<u>\$ 98,720</u>	<u>\$ 231,995</u>	<u>\$ 617</u>	<u>\$ 1,284,953</u>

In the near term, Canada Southern expects to rely on internally generated cash flows and current cash on hand to provide a solid base level of funding of the Company's annual capital expenditure program.

**Critical Accounting Policies**

*Use of estimates*

Inherent in the preparation of financial statements is the use of estimates and assumptions regarding certain assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly actual results may differ from the estimated amounts. Areas that involve the use of significant estimates critical to an understanding of the accounts of Canada Southern are outlined below.

*Full cost ceiling test calculations*

Canada Southern follows the full cost method of accounting for its oil and gas properties. The full cost method requires Canada Southern to calculate on a quarterly basis, a "ceiling test" or limitation of the amount of properties that can be capitalized on the balance sheet.

The ceiling test is a cost recovery test that compares the expected future net revenues from the Company's oil and gas assets (adjusted for certain items) with the capitalized or net book value on the consolidated balance sheet. If the capitalized costs on the consolidated balance sheet are in excess of the calculated ceiling, the excess must be immediately written off as a writedown expense.

Effective January 1, 2004, the Company has adopted the new CICA Accounting Guideline AcG-16 "Oil and Gas Accounting – Full Cost". Under the new guideline, cash flows used in the ceiling test calculation are estimated using expected future product prices and costs. Prior to adopting this new standard, constant dollar pricing was used to test impairment. There is no impact on the Company's first quarter 2004 reported financial results as a result of adopting this guideline.

The discounted present value of Canada Southern's proved natural gas, natural gas liquids, and oil reserves is a major component of the ceiling test calculation. This component inherently contains many subjective judgments, such as projected future production rates, the timing of future expenditures, and the economic productive limit of the Company's assets. Canada Southern utilizes the resources of an independent reserves evaluator to evaluate all of its reserves on an annual basis.

**Item 2.**            **Management's Discussion and Analysis of Financial Condition and Results of Operations (Cont'd)**

**Critical Accounting Policies (Cont'd)**

The passage of time provides additional qualitative information regarding the Company's reserves that could result in reserve revisions or re-determinations. Future significant reductions in a property's production or a significant decrease in product pricing could result in a full cost ceiling test writedown.

In addition, significant changes in proven reserves will impact the calculation of depletion.

*Asset retirement obligations*

The determination of the amount of asset retirement obligations, asset retirement costs, reclamation, and other similar activities is subject to the use of significant estimates and assumptions. Such estimates include major items such as the remaining economic reserve life of a property as discussed above, the timing of abandonment, the costs related to the abandonment, and others. Significant changes in any of the assumptions could alter the amount of site restoration.

Effective January 1, 2004 the Company retroactively adopted the Canadian Institute of Chartered Accountants new standard for accounting for asset retirement obligations. This standard requires that the fair value of the statutory, contractual or legal obligation associated with the retirement and reclamation of tangible long-lived assets be recorded when the obligation is incurred, with a corresponding increase to the carrying amount of the related assets. This corresponding increase to capitalized costs is amortized to earnings on a basis consistent with depreciation, depletion, and amortization of the underlying assets. Subsequent changes in the estimated fair value of the asset retirement obligations are capitalized and amortized over the remaining useful life of the underlying asset.

The asset retirement obligation liabilities are carried on the balance sheet at their discounted present value and are accreted over time for the change in their present value. This standard was adopted retroactively on January 1, 2004 and prior period amounts were restated.

*Stock-based compensation*

The Company has adopted the Canadian accounting standard as outlined in the CICA Handbook section 3870, "Stock-based Compensation and Other Stock-based Payments", which requires the use of the fair value method for valuing stock option grants. Under this method, compensation cost attributable to share options granted to employees or directors is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration paid is recorded as an increase to total capital. This standard was adopted retroactively on January 1, 2004 and prior period amounts were restated. Pursuant to the transition rules, the expense recognized applies to stock options granted on or after January 1, 2002.

For U.S. GAAP reporting purposes, the Company has elected to adopt the fair value expense recognition provisions of FAS 123 "Accounting for Stock-based Compensation" and will report using the modified prospective method. This method provides prospective expense recognition for all new awards and the unvested portion of awards granted subsequent to January 1, 1995.

*Revenue recognition*

Canada Southern's accounting policy with respect to revenue recognition is conservative. Revenue under carried interest agreements is recorded in the period when the net proceeds become receivable and measurable and collection is reasonably assured. Under the carried interest agreements Canada Southern receives oil and natural gas revenues net of operating and capital costs incurred by the working interest participants. The time the net revenues become receivable and collection is reasonably assured depends on the terms and conditions of the relevant agreements and the practices followed by the operator. As a result, net revenues may lag the production month by one or more months.

### **Item 3.**            **Quantitative and Qualitative Disclosure About Market Risk**

Canada Southern does not have any significant exposure to financial market risk as the only market risk sensitive instruments are investments in commercial paper and marketable securities. At March 31, 2004, the carrying value of such investments (including those classified as cash and cash equivalents) was \$36,822,172, which was approximately equal to fair value and face value of the investments.

Canada Southern utilizes the guidance provided from the Dominion Bond Rating Service Limited ("DBRS") Commercial Paper and Short Term Rating Scale in evaluating its investments. DBRS is one of the benchmark rating services for money market securities in Canada (as are S&P and Moody's in the U.S.). This rating scale is meant to give an indication of the risk that the borrower will not fulfill its repayment obligations in a timely manner. DBRS utilizes three main classifications of investment quality; "R-1" (prime credit quality), "R-2" (adequate credit quality), and "R-3" (speculative). Within each main classification, DBRS uses subset grades to designate the relative standing of credit within the particular category ("high", "mid" or "low"). Generally only Government of Canada guaranteed investments earn an "R-1 high" rating.

To ensure capital preservation, Canada Southern's investment policy allows only for investments within the highest quality ratings of R-1 (high, mid, or low). Given that credit ratings can change rapidly in today's economy, Canada Southern's current practice is to invest in a particular investment for periods no longer than 90 days. As a result of the strategy to select high quality investments in combination with short terms to maturity, Canada Southern expects to hold the investments to maturity, and realize maturity value.

In addition, the investments in marketable securities included investments held in United States currency, which are subject to foreign exchange fluctuations. At March 31, 2004, the U.S. dollar investments totaled \$1,959,828 (U.S. \$1,498,225) (December 31, 2003 - \$2,067,193; U.S. \$1,596,781).

### **Item 4.**            **Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Chief Financial Officer (collectively the "Executives"), of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Securities and Exchange Act of 1934) as of March 31, 2004. Based on this evaluation, the Executives concluded that the Company's disclosure controls and procedures were effective such that the material information required to be included in the Company's Securities and Exchange Commission ("SEC") reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms relating to the Company and its consolidated subsidiaries, and was made known to them by others within those entities, particularly during the period when this report was being prepared.

#### **Changes in Internal Controls**

No change in the Company's internal control over financial reporting occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1.        Legal Proceedings**

#### **Settlement of Kotaneelee Litigation**

On September 9, 2003, the parties in the litigation concerning the Kotaneelee gas field entered into a comprehensive Settlement Agreement. (For details of the litigation see Item 3 Legal Proceedings of the Company's Annual Report on Form 10-K dated March 27, 2003, as amended by the Company's Form 10-K/A dated April 30, 2003).

The settlement was finalized on October 3, 2003. Pursuant to the settlement there has been a complete abandonment of the litigation, including the claim that the defendants failed to fully develop the field.

In the fourth quarter of 2003, the Company realized a gross pre-income tax amount of \$22,727,000 in the settlement, which amount represents a complete settlement of the litigation, including a recovery of the wrongfully withheld gas processing fees and related interest. These proceeds constitute taxable income for Canadian income tax purposes upon receipt by the Company.

In connection with the settlement, Canada Southern acquired on October 31, 2003, from Perkins Holdings, Ltd. and Levcor International Inc., a 0.67% carried interest in Kotaneelee formerly held by Levcor, including the associated interest in the litigation.

Also in connection with the settlement, the Company agreed to be responsible for its share of abandonment and reclamation liabilities at the Kotaneelee field when they occur. It is estimated that the Company's 30.67% share of the abandonment liabilities will amount to approximately \$2,400,000 (undiscounted).

The settlement agreement does not include any understandings with or commitments by the working interest owners to further develop the Kotaneelee field beyond those mechanisms for doing so contained in the joint venture agreements.

#### **Litigation Contingent Interests**

In 1991 and 1997 the Company granted contingent interests in certain net recoveries from the Kotaneelee litigation. After the settlement with the defendants was agreed upon, the Company's Board of Directors established a committee comprised solely of directors with no direct or indirect personal interest in the matter of the contingent interests. This independent committee of directors, comprised of Messrs. Kanik, McGinity and Stewart, consulted with independent outside counsel with regard to what amounts, if any, were payable pursuant to the contingent interests.

In early October 2003, counsel to the independent committee advised each of the contingent interest grantees that the committee had concluded, based on advice of counsel, that there was no entitlement arising under such interests.

Mr. Arthur B. O'Donnell (a director of Canada Southern Petroleum Ltd. since 1997), a beneficial holder of a 0.333% contingent interest (derived from G&O'D Inc.), Mr. James R. Joyce, a beneficial holder of a 0.333% contingent interest (derived from G&O'D Inc.), and Murtha Cullina LLP (Mr. Timothy L. Largay, a partner of the firm, has been a director of Canada Southern Petroleum Ltd. since 1997), a grantee of a 1.00% contingent interest, had each notified counsel to the committee of their agreement with the committee's conclusion.

Prior to the conclusion of the independent committee that the contingent interest grantees had no entitlement arising under such interests, the Company had received communications from counsel representing the 2.0% contingent interest granted to C. Dean Reasoner asserting entitlements arising under grants.



**Item 1.**            **Legal Proceedings (Cont'd)**

**Litigation Contingent Interests (cont'd)**

The following grantees, each of whom previously served as litigation counsel to the Company, had advised the Company that they disagreed with the committee's conclusion:

Robert J. Angerer, Sr., Esq.	2.00%
V. A. MacDonald, Esq.	0.75%
Peter McMahon, Esq.	1.00%

These grantees had asserted that the contingent interests applied to the withheld processing fees, production revenues from the field, and other alleged recoveries which could total more than \$200,000,000. The Company did not accept their position.

The Company was advised that certain contingent interest grantees had retained legal counsel to advise them on and pursue the matter with the Company.

In March 2004, in order to avoid a potentially prolonged, expensive and distracting litigation, the Company reached an agreement for an all-inclusive settlement with certain parties, including a former director and former litigation counsel to the Company, who were asserting claims of entitlement against the Company's net recoveries in the Kotaneelee litigation. Under the terms of the settlement, which had been accrued in the Company's fourth quarter 2003 financial results, Canada Southern paid these parties a total of \$1,000,000 in return for a general release from the parties asserting the claims and an agreement by the Company not to seek an adjustment in the prior payments for professional services made to prior litigation counsel.

The independent committee of the Board, created to consider the matter of the contingent interests, remains of the view that there should be no entitlements under the contingent interest grants. However, after lengthy consideration of the matter, involving continuous participation by outside counsel retained by the independent committee for this purpose, the independent committee reluctantly recommended that the Board of Directors approve the settlement summarized above. It was the view of the independent committee and the Board of Directors that, on balance, the shareholders are better served by the Company focusing its human and financial resources on strategically repositioning Canada Southern rather than enduring the distraction of a potentially prolonged and expensive litigation the ultimate outcome of which could not be known with certainty.

**Item 5.**            **Other Information**

On April 29, 2004, the Company issued a press release announcing that that the Board of Directors has nominated Mr. John W. A. McDonald, the Company's newly appointed President and Chief Executive Officer, for election by the shareholders to the Board of Directors at the Annual General Meeting of Shareholders to be held on June 15, 2004. On April 30, 2004, the Company issued a press release announcing two important developments respecting the Company's interests in the Kotaneelee producing gas field and undeveloped acreage at Kotaneelee in the Yukon Territory. Copies of these press releases were attached as Exhibits to the Company's current report on Form 8-K filed on May 3, 2004.

**Item 6.**            **Exhibits and Reports on Form 8-K**

(a)    Exhibits

- 3.1      Memorandum of Association as amended on June 30, 1982, May 14, 1985 and April 7, 1988 filed as Exhibit 4B to Form S-8 as filed on November 25, 1998 (File number 001-03793) is incorporated by reference.
- 3.2      By-laws, as amended, filed as Exhibit 4C to Form S-8 as filed on November 25, 1998 (File number 001-03793) are incorporated by reference.
- 10.1     Employment Contract between Canada Southern Petroleum Ltd. and Randy L. Denecky, dated September 12, 2003, filed herewith.
- 10.2     Executive Employment Agreement between Canada Southern Petroleum Ltd. and John W. A. McDonald, dated March 31, 2004, filed herewith.
- 31.1     Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, filed herewith.
- 31.2     Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, filed herewith.
- 32       Certifications by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

(b)    Reports on Form 8-K

No current reports on Form 8-K were filed during the fiscal quarter ended March 31, 2004.

A current report on Form 8-K was filed on May 3, 2004, reporting that the Company had issued press releases dated April 29, 2004 and April 30, 2004 regarding the matters discussed in Part II, Item 5 of this report.

**CANADA SOUTHERN PETROLEUM LTD.**

**FORM 10-Q**

March 31, 2004

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**CANADA SOUTHERN PETROLEUM LTD.**

Registrant

Date: May 10, 2004

by /s/ John W. A. McDonald  
John W. A. McDonald  
President and Chief Executive Officer

## **Exhibit 10.1**

EMPLOYMENT CONTRACT (effective January 1, 2003)

BETWEEN:

Mr. Randy L. Denecky, of the City of Calgary, in the Province of Alberta (hereinafter called "the Executive")

–and –

Canada Southern Petroleum Ltd., a body corporate (hereinafter called "the Corporation")

WHEREAS the Executive has been employed with the Corporation as Chief Financial Officer pursuant to the provisions of an agreement dated November 1, 2001 (as subsequently amended), the terms of which the Corporation and the Executive wish to amend by this Agreement;

AND WHEREAS the Executive has temporarily assumed the additional role of Acting President of the Corporation since January 7, 2002;

AND WHEREAS the Board of Directors of the Corporation recognizes that the Executive has been instrumental in the development of the Corporation and that it is in the best interests of the Corporation to secure the future employment of the Executive with the Corporation pursuant to the provisions of this Agreement;

AND WHEREAS the Corporation and the Executive have agreed that the employment of the Executive by the Corporation will be in accordance with the provisions of this Agreement;

THEREFORE, for and in consideration of the sum of \$10.00 now paid by each party to the other party (the receipt and sufficiency of which is hereby acknowledged by each of the parties hereto) and the mutual covenants and agreements hereinafter contained, the parties hereto covenant and agree, each with the other, as follows:

### **1. EMPLOYMENT AND TERMS**

- 1.1 The Corporation hereby employs the Executive and appoints him to be Chief Financial Officer to supervise the Corporation's business activities and employees in all respects upon the terms and conditions herein provided, which terms and conditions the Executive hereby accepts. The Executive shall perform such duties and exercise such powers commensurate with his office as are usually and customarily conferred upon a person holding such office, subject always to the reasonable direction of the Board of Directors of the Corporation.
- 1.2 For the purposes of this Agreement, the appointment and employment of the Executive shall commence January 1, 2003 and shall continue for an initial term expiring December 31, 2003 (herein call "the Term") and thereafter from year to year unless terminated by the Corporation or the Executive as hereinafter provided, or amended by the Corporation and the Executive.
- 1.3 During the term of this Agreement, the performance of the Executive's duties under this agreement shall be based in the City of Calgary, in the Province of Alberta and he shall not be required to relocate.

### **2. REMUNERATION**

- 2.1 During the term of this Agreement, the Corporation shall pay to the Executive an annual base salary of \$127,000 per annum as adjusted hereunder (the "Salary"), payable bi-monthly.
- 2.2 The Executive shall be eligible to receive an annual bonus of up to 25% of the base annual salary, at the sole discretion of the Compensation Committee of/or the Board of Directors of the Corporation.
- 2.3 The Executive shall be reimbursed for all expenses reasonably and necessarily incurred personally by him on behalf of the Corporation, provided that copies of expenses are appropriately furnished in accordance with the Corporation's reimbursement policy as established from time to time.

- 2.4 Effective on the commencement of employment by the Corporation, options were granted to the Executive to acquire 45,000 common shares (at a strike price of CDN\$6.81 per share) vesting over 2.5 years as provided in the option grant (unless accelerated vesting occurs pursuant to paragraph 6.3 or 8.4 below) of the Corporation in accordance with the Corporation's prevailing stock option plan.
- 2.5 As part of the overall review of compensation as described under paragraph 2.6 of this agreement the Compensation Committee of/or the Board of Directors shall conduct an annual review of the number of share options granted to the Executive.
- 2.6 The Compensation Committee of/or the Board of Directors shall conduct an annual review of the total compensation of the Executive to insure that the compensation remains fair when compared to similar positions in the oil and gas industry in Calgary, Canada. Such a review does not constitute an agreement to adjust any of the components of the compensation of the Executive.

### 3. CORPORATION BENEFITS

- 3.1 The Corporation shall provide all benefits to the Executive in accordance with the Corporation's employee benefits plan from time to time.
- 3.2 The Corporation agrees to reimburse the Executive for annual professional dues and related professional development courses.
- 3.3 The Corporation agrees to provide or reimburse the Executive for expenses related to parking a vehicle at or near the corporate offices.
- 3.4 The Corporation shall pay the cost of membership, including initiation fees, in such business and other clubs as are mutually agreed upon by the parties to be in the business interests of the Corporation.

### 4. VACATION

- 4.1 In each fiscal year of the Corporation the Executive shall be entitled to a period of vacation of not less than four (4) weeks in any one year in addition to all statutory holidays and such vacation may be taken in such manner and at such time as the Executive shall reasonably determine with due regard for the operating requirements of the Corporation. The Executive may carry unused vacation from any given year into the following year only. Vacation carried forward into a subsequent year must be used during that subsequent year, or, if not used will be compensated to the Executive at his then prevailing base monthly salary.

### 5. TERMINATION FOR JUST CAUSE

- 5.1 The Corporation may terminate the employment of the Executive hereunder, by written notice given to the Executive after the happening of any of the events hereinafter set forth:
  - 5.1.1 if the Executive resigns from the office of Chief Financial Officer of the Corporation without the consent of the Corporation; or
  - 5.1.2 if the Executive is at any time guilty of any other material breach or non-observance of any material provisions of this Agreement or of his fiduciary obligations to the Corporation; or
  - 5.1.3 if the Executive is convicted of any criminal offence, or a civil offense involving fraud or dishonesty; or
  - 5.1.4 any other "cause" as determined in accordance with the Laws of Alberta.
- 5.2 In the event of the termination of the Executive's employment pursuant to this Paragraph, the Corporation shall pay to the Executive and/or his personal representatives in such manner as he may direct:
  - 5.2.1 his Salary, if unpaid, up to and including the effective date of termination, and

5.2.2 the aggregate amount for vacation accrued, up to and including the effective date of termination.

## 6. TERMINATION AT THE CONVENIENCE OF THE CORPORATION

6.1 The Corporation may also terminate the employment of the Executive hereunder at any time without cause, by prior written notice given to the Executive.

6.2 In the event of the termination of the Executive's employment pursuant to paragraph 6.1, the Corporation shall pay to the Executive:

6.2.1 an aggregate amount equal to his Salary, if unpaid, up to and including the effective date of termination; and

6.2.2 the aggregate amount for vacation accrued, up to and including the effective date of termination; and

6.2.3 an amount equal to twelve (12) times the Executive's base monthly salary, plus two (2) times the Executive's base monthly salary (immediately preceding the date of termination) for each completed and partially completed year of service (beginning January 1, 2003), to an overall maximum of twenty-four (24) times the Executive's base monthly salary; and

6.2.4 an amount equal to the most recent annual bonus received by the Executive as contemplated in paragraph 2.2; and

6.2.5 an amount equal to the present worth of all employee benefits as referred to in paragraphs 3.1, 3.2, 3.3, and 3.4, which the Executive would have received or which would have been available to the Executive for a period of twelve (12) months plus two (2) months for each completed and partially completely year of service (beginning January 1, 2003), to an overall maximum of twenty-four (24) months from the effective date of termination; and

6.2.6 any outstanding amounts previously earned which remain unpaid in any incentive compensation plan in which the Executive participates.

6.3 In the event of a termination pursuant to Paragraph 6.1 all of the Executive's previously unvested options shall vest. Vested options under this clause would be exercisable for a period of 90 days from the effective date of termination.

## 7. TERMINATION BY EXECUTIVE

7.1 The Executive may terminate his appointment and employment upon ninety (90) days prior written notice to that effect to the Corporation.

7.2 The Executive shall have the right to terminate this Agreement forthwith upon the occurrence of any one or more of the following events:

7.2.1 if the Corporation becomes insolvent or adjudicated bankrupt; or

7.2.2 upon the commencement of proceedings for the dissolution of the Corporation; or

7.2.3 any serious breach or non-observance of the conditions of this Agreement by the Corporation, which continues after the Corporation has been notified in writing of and been given an adequate period of time to correct such breach or non-observance; or

7.2.4 if there is any material reduction in the responsibilities or authority of the Executive, whether or not the title of Chief Financial Officer is removed; or

7.2.5 if there is any change amounting to a reduction in reporting requirements for the Executive such that he no longer reports to the Board of Directors, whether or not the title of Chief Financial Officer is removed; or

- 7.2.6 in the event that the Corporation requests the Executive to relocate his residence to a different city than Calgary, Alberta, and the Executive does not agree to such relocation.
- 7.3 On notice of termination of this Agreement by the Executive as provided under paragraph 7.1, the Corporation shall only be required to pay the Executive his salary and benefits until the effective date of the termination and may either require the Executive to continue to perform his duties or dismiss the Executive at any time after delivery of the notice.
- 7.3.1 On notice of termination of the Agreement by the Executive as provided under paragraphs 7.2.1 to 7.2.6 inclusive, the Corporation shall be required to pay the Executive all amounts referred to in paragraphs 6.2.1 to 6.2.6 inclusive within fifteen (15) days after the effective date of termination, and all of Executive's previously unvested options shall vest. Vested options under this clause would be exercisable for a period of 90 days from the effective date of termination.
- 7.3.2 The total amounts due to the Executive shall be paid by the Corporation in a lump sum, and not in the form of salary continuance.

## 8. TERMINATION BY REASON OF REORGANIZATION OR CHANGE OF CONTROL

- 8.1 For purposes of this Agreement the Corporation shall be deemed, at the sole election of the Executive pursuant to this paragraph 8.1, to have given to the Executive written notice of termination without cause (whether or not any written notice of termination is in fact given) if any change of control as defined in 8.2 below ("Change of Control") occurs with respect to the Corporation. In the event of such Change of Control, the Executive may exercise his election by giving notice in writing to the Corporation. Such notice may be given by the Executive to the Corporation at any time during the period that (i) begins on the effective date of any Change of Control that occurs during the term of this agreement and (ii) ends 365 calendar days thereafter. Following a Change of Control during the term of this agreement, subsequent failure of the Corporation to renew this agreement with Executive shall eliminate neither Executive's right to give notice under this provision at any time during the 365 day following the date of Change of Control nor Corporation's consequent obligation to compensate Executive as provided in Paragraphs 8.1.2 and 8.5 below.
- 8.1.1 Paragraph 8.1 will not apply if prior to the effective date of a Change of Control the Executive has given notice of termination under paragraph 7.1 or the Executive terminates this agreement pursuant to paragraph 7.2.1 to 7.2.6 inclusive.
- 8.1.2 In the event that Executive gives notice to the Corporation as provided in 8.1 above, Corporation may require use of Executive's services as defined in 1.1 above for up to 90 calendar days beyond the date of notice from the Executive, provided that, compensation for Executive's services during this period must be agreeable to the Executive. Compensation during this period of up to 90 calendar days shall be in addition to all compensation owed to Executive as provided in Paragraph 8.5 and its subparagraphs below.
- 8.2 For purposes of the Agreement, "Change of Control" means and includes any of the following:
- 8.2.1 the acquisition by any person or corporation, or any persons or corporations acting jointly or in concert, whether directly or indirectly, of voting securities of the Corporation which, together with all other voting securities of the Corporation held by such persons or corporations, constitutes, in the aggregate, more than 30% of all outstanding voting securities of the Corporation; or
- 8.2.2 an amalgamation, merger, arrangement, or other form of business combination of the Corporation with another corporation which results in the holders of the voting securities of that other corporation holding, in aggregate, 30% or more of all outstanding voting securities of the Corporation resulting from the business combination; or
- 8.2.3 the sale, lease or exchange of all or substantially all of the assets of the Corporation, provided that any sale or exchange of the Corporation's interest in the Kotaneelee field shall not be deemed to be a sale or

exchange of substantially all of the assets, so long as the Corporation continues to be involved in the business of oil and gas; or

- 8.2.4 individuals who are members of the Board of Directors of the Corporation immediately prior to a meeting of the Shareholders of the Corporation involving a contest for the election of directors shall not constitute a majority of the Board of Directors following that election.
- 8.3 In the event of the termination of the Executive's employment pursuant to paragraph 8.1 above, the Corporation shall pay to the executive, within fifteen (15) days after the effective date of the termination, all entitlements as described under paragraph 8.5 and all of its subparagraphs below.
- 8.4 In an event of a Change of Control as provided in 8.1 and 8.2 above, all the Executive's previously unvested options shall vest. Vested options under this clause shall be exercisable for a period of 90 days from the effective date of termination.
- 8.5 In the event of termination of the Executive pursuant to Paragraph 8.1 above, the Corporation shall pay to the Executive:
  - 8.5.1 an aggregate amount equal to his Salary, if unpaid, up to and including the effective time of termination; and
  - 8.5.2 the aggregate amount for vacation accrued, up to and including the effective time of termination; and
  - 8.5.3 an amount equal to twelve (12) times the Executive's base monthly salary, plus two (2) times the Executive's base monthly salary (immediately preceding the date of termination) for each completed and partially completed year of service (beginning January 1, 2003), to an overall maximum of twenty-four (24) times the Executive's base monthly salary; and
  - 8.5.4 an amount at the discretion of the Executive equal to either:
    - 8.5.4.1 the most recent annual bonus received by the Executive as contemplated in paragraph 2.2, or
    - 8.5.4.2 the most recent annual bonus received by the Executive as contemplated in paragraph 2.2 prior to a Change of Control; and
  - 8.5.5 the present worth of all employee benefits as referred to in paragraphs 3.1, 3.2, 3.3, and 3.4, which the Executive would have received or which would have been available to the Executive for a period of twelve (12) months plus two (2) months for each completed and partially completely year of service (beginning January 1, 2003), to an overall maximum of twenty-four (24) months from the effective date of termination; and
  - 8.5.6 any outstanding amounts previously earned which remain unpaid in any incentive plan in which the Executive participates
  - 8.5.7 The total amounts due to the Executive under this paragraph and its subparagraphs shall be paid by the Corporation in a lump sum, and not in the form of salary continuance.



## 9. PROHIBITIONS AGAINST ASSIGNMENT

- 9.1 The Executive shall not be at liberty to assign or delegate to others this agreement or any of its functions and duties hereunder (other than duties and functions customarily and necessarily delegated to others under the normal course of business) without first receiving the written consent of the Board of Directors of the Corporation.

## 10. DUTIES AND INDEMNIFICATION

- 10.1 The Executive shall, during the Terms of this Agreement, devote the whole of his time and attention to the business of the Corporation and shall adhere to all conflict of interest and other policies of the Corporation in effect from time to time.
- 10.2 The Executive may, from time to time, serve as a member of the board of directors of other non-related companies and organizations, provided the Executive first receives the approval of the Board of Directors of the Corporation.
- 10.3 The Corporation agrees to indemnify the Executive to the maximum extent permitted under the Alberta Business Corporations Act against any and all liabilities arising out of or in the course of his acting as Chief Financial Officer (or any other position) of the Corporation or any of its subsidiaries which are incurred by him or imposed upon him by operations of law (the Indemnified Liabilities). If the Alberta Business Corporations Act should be amended so as to be silent on the extent to which Corporations can indemnify Officers, the Corporation shall indemnify the Executive against all Indemnified Liabilities except:
- a) liability for gross negligence or fraud or other acts of willful misfeasance; and,
  - b) any liability the assumption of which by the Corporation is prohibited by law.
- 10.4 The Corporation agrees to reimburse all of the Executive's legal and arbitration fees and disbursements, on a solicitor and own client basis, expended to enforce the terms of this agreement.

## 11. ARBITRATION

- 11.1 Any dispute or difference arising between the parties hereto as to the construction of this Agreement or the rights, duties or obligations of either party hereunder or any matter arising out of or concerning the Executive's employment or salary hereunder payable to the Executive shall be submitted to arbitration in the City of Calgary and settled by the award of three arbitrators or a majority of them. One arbitrator shall be named by the Corporation, one by the Executive and a third by the first two arbitrators. Either the Corporation or the Executive may submit a dispute or matter of difference to arbitration by appointing the first arbitrator and serving the other party with a notice thereof along with a notice to appoint the second arbitrator. If either party shall neglect or refuse or fail for any reason to name his/its arbitrator or to proceed with the said arbitration, the arbitrator named by the other party shall proceed to decide the issue on his/her own. Any arbitration award shall be final and enforceable by legal action in any jurisdiction where the defaulting Corporation has assets. The Arbitration Act, R.S.A. 2000, as amended from time to time shall govern any arbitration.

## 12. ADDITIONAL PROVISION

- 12.1 Except as herein set out the provisions of agreement between the parties dated November 1, 2001 (as amended) shall continue to be in full force and effect.

## 13. GOVERNING LAW

- 13.1 This Agreement shall be construed and enforced in accordance with, and the laws of the Province of Alberta hereto shall govern rights of the parties. Each of the parties hereto hereby irrevocably attorns to the jurisdiction of the courts of the Province of Alberta.

#### 14. NOTICES

- 14.1 All notices as required hereunder shall be provided by registered mail to the parties hereto at the addresses as follows:

To the Corporation:

Canada Southern Petroleum Ltd.  
Suite 250, 706 – 7<sup>th</sup> Avenue SW  
Calgary, Alberta, T2P 0Z1

Or at its Registered office as may be shown from time to time on the records of the Registrar of Companies for the Province of Nova Scotia.

To the Executive:

Randy L. Denecky  
c/o Canada Southern Petroleum Ltd.  
Suite 250, 706 – 7<sup>th</sup> Avenue SW  
Calgary, Alberta, T2P 0Z1

Any notice, direction or other instrument aforesaid shall, if delivered, be deemed to have been given and received on the day on which it was so delivered, and if not a business day, then on the business day next following the day of delivery, and if mailed (except in the case of an active or threatened regional or national mail strike), be deemed to have been given and received on the third day following the day on which it was so mailed, and, if sent by telegram, telex, telecommunication or other similar form of communication, be deemed to have been given and received on the second business day following the day it was sent.

If for any reason, the method for giving notice selected by a party is impractical, that party shall be obliged to select an alternate method of giving notice.

Either party may change its address for notice in the aforesaid manner.

#### 15. HEADINGS

- 15.1 The headings in this Agreement are inserted for convenience of reference only and shall not affect the construction or interpretation of this agreement.

#### 16. ENTIRE AGREEMENT

- 16.1 This agreement and everything herein contained shall enure to the benefit of and be binding upon the parties hereto together with their personal representatives, successors and permitted assigned.

IN WITNESS WHEREOF the Corporation has caused its corporate seal to be hereunto affixed attested by the hands of its proper officers duly authorized in that behalf and the Executive has hereunto set his hand and seal the 12th day of September, 2003

SIGNED, SEALED & DELIVERED  
in the presence of:

/s/ Gordon Thompson  
Witness

/s/ Randy L. Denecky  
Mr. Randy L. Denecky

Canada Southern Petroleum Ltd.

Per: /s/ Richard C. McGinity  
Richard C. McGinity  
Chairman of the Board of Directors

## **Exhibit 10.2**

### **EXECUTIVE EMPLOYMENT AGREEMENT**

This Agreement dated and made effective as of the first day of April, 2004.

#### **BETWEEN:**

**CANADA SOUTHERN PETROLEUM LTD.**, a company incorporated pursuant to the laws of the Province of Nova Scotia and having offices in Calgary, Alberta (the "Corporation")

- and -

**JOHN W.A. McDONALD**, a professional engineer residing in Calgary, Alberta (the "Executive")

**WHEREAS** the Corporation wishes to retain the services of the Executive, in the capacity of President and Chief Executive Officer of the Corporation, to assist in the furtherance of its Business;

**AND WHEREAS** the Corporation and the Executive have agreed that their relationship will be governed by the terms and conditions of this Agreement;

**NOW THEREFORE THIS AGREEMENT WITNESSETH** that in consideration of the provision of services by the Executive to the Corporation, and the employment of the Executive by the Corporation, and for other good and valuable consideration, the receipt and sufficiency of which is acknowledged by the parties hereto, the parties agree as follows:

#### **ARTICLE I DEFINITIONS AND INTERPRETATION**

1.1 In this Agreement, including the recitals hereto, the following terms shall have the following meanings:

- (a) "Act" means the *Alberta Business Corporations Act*, as amended;
- (b) "Affiliated" has the meaning set out in the Act, and an "Affiliate" means one of two or more Affiliated bodies corporate;
- (c) "Agreement" means this Executive Employment Agreement, as from time to time supplemented or amended by one or more agreements entered into pursuant to the applicable provisions hereof;
- (d) "Base Salary" means the amount paid to the Executive annually by the Corporation pursuant to Section 5.1;
- (e) "Benefits" means those amounts or entitlements provided, or paid for, by the Corporation in respect of the Executive pursuant to Article VI;
- (f) "Board of Directors" means the board of directors of the Corporation;
- (g) "Business" means the business of the Corporation;

- (h) “Cause” means any reason which would entitle the Corporation to terminate the Executive’s employment without notice or payment in lieu of notice at common law, or under the provisions of any other applicable law or regulation and includes, without limiting the generality of the foregoing:
- (i) fraud, misappropriation of the Corporation’s property or funds, embezzlement, malfeasance, misfeasance or nonfeasance in office which is willfully or grossly negligent on the part of the Executive;
  - (ii) the willful allowance by the Executive of his duty to the Corporation and his personal interests to come into conflict in a material way in relation to any transaction or matter that is of a substantial nature; or
  - (iii) the breach by the Executive of any of his covenants or obligations under this Agreement, including any non-competition, non-solicitation or confidentiality covenants with the Corporation;
- (i) “Change of Control” means the occurrence of any of the following:
- (i) the purchase or acquisition by whatever means of any Shares by a Holder which results in the Holder beneficially owning, or exercising control or direction over Shares such that, assuming the conversion of Shares beneficially owned or over which control or direction is exercised by the Holder, the Holder would beneficially own or exercise control or direction over Shares (together with such Holder’s then owned Shares, if any) carrying the right to cast more than 51% of the votes attaching to all Shares;
  - (ii) the amalgamation, consolidation or merger of the Corporation with any other corporation pursuant to which the shareholders of the Corporation immediately prior to such transaction do not own shares of the successor or continuing corporation which would entitle them to cast a majority of the votes attaching to shares in the capital of the successor or continuing corporation which might be cast to elect directors of that corporation;
  - (iii) the sale, lease or transfer by the Corporation of all or substantially all of the assets of the Corporation to any Person other than a Related Corporation;
  - (iv) approval by the shareholders of the Corporation of the liquidation, dissolution or winding-up of the Corporation; or
  - (v) a situation in which the majority of the Board of Directors, following a meeting of the shareholders of the Corporation involving a contest for, or an item of business relating to, the election of directors, are not management nominees to the Board of Directors.
- (j) “Corporate Property” includes any and all proprietary technology, financial, operating and training information, all works of expression and any copyrights in such works, current or potential business contacts and contract development information, patentable inventions, discoveries or trade secrets, and any materials, tools, equipment, devices, records, files, data, tapes, computer programs, computer disks, software, communications, letters, proposals, memoranda, lists, drawings, blueprints, correspondence, specifications or any other documents or property belonging to the Corporation or any Related Corporations;
- (k) “Confidential Information” means any information of a confidential nature which relates to the Business of the Corporation or any Related Corporation, including trade secrets, technical information, patents, marketing strategies, sales and pricing policies, financial information, business, marketing or technical plans, programs, methods, techniques, concepts, formulas, documentation, intellectual property, software, industrial designs, products, technical studies and data, strategic studies, engineering information, client and supplier lists, shareholder data and

personnel information. Notwithstanding the foregoing, Confidential Information shall not include any information which:

- (i) was in the possession of or known to the Executive, without any obligation to keep it confidential, before it was disclosed to the Executive by the Corporation;
  - (ii) is or becomes public knowledge through no fault of the Executive;
  - (iii) is independently developed by the Executive outside the scope of his employment duties to the Corporation;
  - (iv) is disclosed by the Corporation to another Person without any restriction on its use or disclosure; or
  - (v) is or becomes lawfully available to the Executive from a source other than the Corporation.
- (l) “Effective Date” means the date as set forth on page one of this Agreement;
- (m) “Excluded Reason” means the termination of the Executive’s employment by the Corporation for Cause pursuant to Section 9.2, by the Executive pursuant to Section 10.1, or termination upon Death or Permanent Disability pursuant to Article XI;
- (n) “Holder” means any Person or group of Persons acting jointly or in concert, or associated or Affiliated with any such Person, group of Persons or any of such Persons acting jointly or in concert;
- (o) “Monthly Base Salary” means the annual Base Salary paid to the Executive, divided by 12;
- (p) “Notice” means any Notice given by one Party to the other Party in accordance with Article XV;
- (q) “Party” means one or other of the Executive and the Corporation, and “Parties” means both the Executive and the Corporation;
- (r) “Permanent Disability” means a mental or physical disability whereby the Executive:
- (i) is unable, due to illness, disease, mental or physical disability or similar cause, to fulfill his obligations as an employee or officer of the Corporation for a cumulative period of 9 months out of 12 consecutive calendar months; or
  - (ii) is declared by a Court of competent jurisdiction to be mentally incompetent or incapable of managing his affairs;
- (s) “Person” includes an individual, partnership, association, body corporate, trustee, executor, administrator or legal representative, and “Persons” means a group of more than one Person;
- (t) “Related Corporation” means any subsidiary corporation or partnership, division, Affiliate, predecessor or successor of the Corporation;
- (u) “Remuneration” means the Base Salary and other amounts the Executive is entitled to receive pursuant to Article V;
- (v) “Severance Period” shall be 12 months plus 2 additional months notice or pay in lieu of notice for each additional complete year of service after the first complete year of service, to a maximum of 24 months notice of pay in lieu of notice;

- (w) “Shares” means before the voting shares of the Corporation;
  - (x) “Term” means the period during which this Agreement remains in force pursuant to Article III; and
  - (y) “Termination Date” means the last day actively worked by the Executive for the Corporation.
- 1.2 The headings in this Agreement are inserted for convenience and ease of reference only, and shall not affect the construction or interpretation of this Agreement.
  - 1.3 All words in this Agreement importing the singular number include the plural, and vice versa. All words importing gender include the masculine, feminine and neuter genders.
  - 1.4 All monetary amounts are in Canadian dollars.
  - 1.5 The word “including”, when following any general statement or term, is not to be construed as limiting the general statement or term to the specific items or matters set forth or to similar items or matters, but rather as permitting the general statement or term to refer to all other items or matters that could reasonably fall within its broadest possible scope.
  - 1.6 A reference to a statute includes all regulations made thereunder, all amendments to the statute or regulations in force from time to time, and any statute or regulation that supplements or supersedes such statute or regulations.
  - 1.7 A reference to an entity includes any successor to that entity.
  - 1.8 A reference to “approval”, “authorization” or “consent” means written approval, authorization or consent.
  - 1.9 A reference to an Article is to an Article of this Agreement and the reference to a Section followed by a number or some combination of numbers and letters refers to the section, paragraph, subparagraph, clause or subclause of this Agreement so designated.

## **ARTICLE II EMPLOYMENT OF EXECUTIVE**

- 2.1 The Corporation agrees to employ the Executive as the President and Chief Executive Officer, and the Executive agrees to accept such employment, all in accordance with the terms and conditions of this Agreement.
- 2.2 The Parties agree that the relationship between the Corporation and the Executive is that of employer and employee.

## **ARTICLE III TERM OF AGREEMENT**

- 3.1 The Term and the Executive’s employment with the Corporation shall be for a three year period from the Effective Date, unless earlier terminated by the Corporation or the Executive pursuant to the terms and conditions of this Agreement.
- 3.2 This Agreement may only be extended beyond the Term, by mutual agreement between the Executive and the Corporation, expressed in writing.

## **ARTICLE IV DUTIES OF EXECUTIVE**

4.1 The Executive shall, during the Term:

- (a) perform the duties and responsibilities of the President and Chief Executive Officer of the Corporation, including all those duties and responsibilities customarily performed by a person holding the same or an equivalent position in corporations of a similar size to the Corporation in a similar Business to that of the Corporation in Canada, as well as such other related duties and responsibilities as may be assigned to the Executive by the Board of Directors from time to time;
- (b) accept such other office or offices which he may be elected or appointed by the Board of Directors in addition to that of President and Chief Executive Officer; and
- (c) devote the whole of his working time, attention, efforts and skill to the performance of his employment duties and responsibilities as set out herein, and truly and faithfully serve the best interests of the Corporation at all times. In particular, and without limiting the generality of the foregoing, the Executive shall not engage in any personal activities or any employment consulting work, trade or other business activity on his own account or on behalf of any other Person which may compete, conflict or interfere with the performance of the Executive's duties hereunder in any way, provided that, Executive shall be entitled to provide temporary assistance to former employer in resolving the Bantry and Cedar Energy matters. Executive shall receive no compensation from former employer in return for providing such temporary assistance, and such assistance shall be rendered to former employer such that Executive's involvement with former employer is minimized and – to the maximum extent possible – such assistance shall be provided outside of normal business hours.
- (d) It shall not be a violation of this paragraph 4.1(c) for the Executive to engage in any activities, voluntary or not, which do not interfere with the Executive's duties under this Agreement,

## **ARTICLE V REMUNERATION**

- 5.1 During the term of this Agreement, the Corporation shall pay to the Executive a salary of \$210,000.00 per annum (the "Base Salary"), less required statutory deductions, payable in equal semi-monthly installments in such a manner as the parties may mutually agree. The Executive's Base Salary will be reviewed annually by the Board of Directors, and may be increased at the sole discretion of the Board of Directors, based upon such factors as the Board of Directors in its sole discretion determines are relevant, which factors may include the performance of the Corporation and the executive compensation arrangements of other corporations of a similar size engaged in a similar Business to that of the Corporation.
- 5.2 The Corporation may also grant the Executive annual or incentive bonuses in an amount of up to 40 per cent of annual base salary, for fully satisfactory performance, or in amounts and on such terms and conditions as the Board of Directors in its sole discretion may determine from time to time, based upon such factors as the Board of Directors in its sole discretion determines are relevant, which factors may include the Executive's performance under the terms of this Agreement and the performance of the Corporation, provided that, in the event of a partial year of service, payment of any Executive bonus under this provision will be pro rated according to the following formula: (number of months employed) x (12).
- 5.3 The Corporation shall reimburse the Executive for all reasonable out-of-pocket expenses incurred in the performance of his employment duties under this Agreement, including all reasonable travel and promotional expenses payable or incurred by the Executive in connection with the performance of his employment duties. All payments or reimbursements of expenses shall be subject to the submission by the Executive of appropriate vouchers, bills and receipts to the Chairman of the Audit Committee of the Board of Directors.



- 5.4 Upon termination of this Agreement for any reason, the Executive shall only be entitled to receive any Remuneration earned up to the Termination Date, in addition to any other severance or termination payments which are payable under the terms of this Agreement.

## **ARTICLE VI BENEFITS**

- 6.1 The Executive shall be entitled to receive the following Benefits while employed by the Corporation:
- (a) paid parking, (however, the Employee acknowledges that such costs will be a taxable benefit);
  - (b) an employee benefit package including medical, dental and other health care group benefits, as well as life and term disability insurance, subject to the terms of the policies provided by the relevant insurer as may be changed from time to time, in the sole discretion of the Corporation or insurer.

## **ARTICLE VII STOCK OPTION**

- 7.1 The Executive is entitled to participate in its Stock Option Plan, as may be amended by the Corporation from time to time. Upon commencing employment with the Corporation, Executive shall be awarded options to buy 100,000 shares of the Limited Voting Stock of the Corporation, under terms and conditions to be established by the Board of Directors.

## **ARTICLE VIII VACATION**

- 8.1 The Executive shall be entitled to an annual vacation of 4 weeks. Vacation may be taken in such a manner and at such times as the Executive and the Corporation mutually agree, subject to the business priorities of the Corporation.

## **ARTICLE IX TERMINATION BY CORPORATION**

- 9.1 The Corporation shall be entitled to terminate this Agreement and the Executive's employment with the Corporation at any time, for any reason, upon Notice to the Executive, in which case:
- (a) subject to Sections 9.2 and 10.3, the Corporation shall pay the Executive the following amounts in full and final settlement of any claims by the Executive against the Corporation or any Related Corporation, arising out of, or in any way connected to, the Executive's employment with the Corporation or any Related Corporation, or the termination of such employment, whether at common law or under the provision of any statute or regulation, or pursuant to any agreement between the Parties:
    - (i) Base Salary for the Severance Period; plus
    - (ii) a lump sum equal to the cost to the Corporation to provide the Benefits referred to in Article VI hereof during the Severance Period, with the exception of any registered pension plans of the Corporation or any Related Corporation, or any supplementary pension benefits that the Executive may be entitled to, or any benefit or entitlement the Executive may have or have had under any registered pension plan or supplementary pension benefits;

- (b) the Executive's right to receive the payment under this Section 9.1 shall not be subject to any duty to mitigate, nor affected by any actual mitigation by the Executive;
  - (c) the obligation of the Corporation to make payments under this Section 9.1 shall be subject to any and all withholdings and deductions required to be made by the Corporation by law;
  - (d) payment under this Section 9.1 shall be subject to the prior execution by the Executive of a Settlement Agreement and Release, on terms acceptable to the Corporation acting reasonably; and
  - (e) the Executive hereby grants the Corporation the right to set-off against any payments to the Executive under this Section 9.1 any amount which the Executive owes to the Corporation, whether immediately due and owing or not.
- 9.2 The Corporation shall be entitled to terminate this Agreement and the Executive's employment with the Corporation at any time, without notice or payment in lieu of notice, for Cause.

## **ARTICLE X TERMINATION BY EXECUTIVE**

- 10.1 The Executive may terminate this Agreement and his employment with the Corporation by providing 90 days' prior Notice to the Corporation. Upon receipt of such Notice of termination by the Executive, the Corporation shall only be required to pay the Executive any Remuneration, and provide the Executive with any Benefits, earned up to the Termination Date, and may either require the Executive to continue to perform his duties until the Termination Date, or dismiss the Executive at any time after receipt of the Notice, without additional compensation or obligation to the Executive.
- 10.2 Subject to the conditions set out in Section 10.4, the Executive may terminate his employment with the Corporation within 90 days following the occurrence of a Change of Control of the Corporation and receive the payment set out in section 10.3.
- 10.3 In the event that the Executive's employment with the Corporation is terminated in strict accordance with Section 10.2, the Corporation shall pay the Executive the following amounts in full and final settlement of any claims by the Executive against the Corporation or any Related Corporation, arising out of or in any way connected to the Executive's employment with the Corporation or any Related Corporation, or the termination of such employment, whether at common law or under the provision of any statute or regulation, or pursuant to the terms of any agreement between the Parties:
- (a) Base Salary for the Severance Period; plus
  - (b) a lump sum equal to the cost to the Corporation to provide the Benefits referred to in Article VI hereof during the Severance Period, with the exception of any registered pension plans of the Corporation or any Related Corporation, or any supplementary pension benefits that the Executive may be entitled to, or any benefit or entitlement the Executive may have or have had under any registered pension plan or supplementary pension benefits.
- 10.4 Payment under Section 10.3 shall be subject to the following conditions:
- (a) the prior execution by the Executive of a Settlement Agreement and Release on terms acceptable to the Corporation;
  - (b) the Executive's full co-operation and assistance, in connection with any Change of Control, to transfer the Executive's duties and responsibilities to a replacement at the request of the Corporation and for a period requested by the Corporation not to exceed 60 days, and the tendering by the Executive of his resignation from any position he may hold as an officer or a

director of the Corporation and any Related Corporations or by virtue of these offices, at such time as the Corporation may request;

- (c) the obligation of the Corporation to make payments under Section 10.3 shall be subject to any and all withholdings and deductions required to be made by the Corporation by law;
- (d) the Executive hereby grants the Corporation the right to set-off against any payments to the Executive under Section 10.3 any amount which the Executive owes to the Corporation, whether immediately due and owing or not;
- (e) the Executive's right to receive the payment under Section 10.3 shall not be subject to any duty to mitigate, nor affected by any actual mitigation by the Executive; and
- (f) payment under Section 10.3 shall be in place of, and not in addition to, any other statutory and common law severance or termination payment in lieu of reasonable notice which may be made to the Executive pursuant to any other term or provision of this Agreement.

- 10.5 In the event that the Executive terminates his employment with the Corporation in any manner other than in strict accordance with the requirements set out in Section 10.2, the Corporation shall have no obligation to pay the Executive any of the amounts or grant the Executive any of the rights set out in Sections 9.1 or 10.3.

#### **ARTICLE XI TERMINATION UPON DEATH OR PERMANENT DISABILITY**

- 11.1 This Agreement shall automatically terminate upon the death of the Executive.
- 11.2 In the event that the Executive shall suffer a Permanent Disability, the Corporation may terminate this Agreement and the Executive's employment by providing 60 days prior Notice to the Executive. Upon termination of the Executive's employment pursuant to this Section 11.2, the Corporation shall have no further obligation or liability to the Executive, with the exception that the Executive shall continue to be entitled to such insurance benefits as he is qualified to receive pursuant to any long term disability plan and to any benefit or entitlement under any pension plan of the Corporation or any executive superannuation undertakings in which the Executive participates and is qualified to receive.
- 11.3 The Executive and the Corporation agree that a termination of the Executive's employment pursuant to Section 11.2 is in respect of a situation consisting of:
- (a) a frustration of the Agreement at law;
  - (b) a breach by the Executive of a bona fide occupational requirement owed to the Corporation; and
  - (c) accommodation of the Executive by the Corporation to the point of undue hardship for the Corporation.

#### **ARTICLE XII PROPERTY RIGHTS**

- 12.1 Although the Executive is not expected to be in a technical development role, for clarity, the Executive acknowledges and confirms that the Corporation shall be entitled to own and control all proprietary technology, and financial, operating, and training ideas, processes, and materials, including works of expression and all copyrights in such works, that are developed, created, or conceived by the Executive during the course of this Agreement (collectively referred to as "Contract Developments"), to the extent that such Contract Developments relate to the Corporation's current or potential Business or if such

Contract Developments were in any part undertaken in connection with this Agreement or with Corporation supplied software or equipment or on the premises of the Corporation or its customers or contractors. Accordingly, the Executive hereby agrees to disclose, deliver, and assign all such patentable inventions, discoveries, and improvements, trade secrets, and all works subject to copyright, and further agrees to execute all documents, patent applications, and arrangements necessary to further document such ownership and/or assignment and to take whatever other steps may be needed to give the Corporation the full benefit of them.

- 12.2 The Executive agrees that all copyrightable materials generated or developed under this Agreement, including computer programs and documentation, shall be considered works made for hire under the copyright laws of Canada and the United States and shall, upon creation, be owned exclusively by the Corporation. To the extent that any such materials, under applicable law, may not be considered works made for hire, the Executive hereby assigns to the Corporation the ownership of all copyrights in such materials, without the necessity of any further consideration, and the Corporation shall be entitled to register and hold in its own name all copyrights in respect of such materials.

### **ARTICLE XIII**

#### **CONFIDENTIAL INFORMATION, NON-SOLICITATION AND NON-COMPETITION**

- 13.1 The Executive acknowledges and agrees that in performing the duties and responsibilities of his employment pursuant to this Agreement, he will occupy a position of high fiduciary trust and confidence with the Corporation, pursuant to which he will develop and acquire wide experience and knowledge with respect to all aspects of the Business carried on by the Corporation and its Related Corporations, and the manner in which such Business is conducted. It is the express intent and agreement of the Executive and the Corporation that such knowledge and experience shall be used solely and exclusively in furtherance of the Business interests of the Corporation and its Related Corporations, and not in any manner detrimental to them. The Executive therefore agrees that, so long as he is employed by the Corporation pursuant to this Agreement, he shall not engage in any practice or business that competes directly with the Business of the Corporation or its Related Corporations. The Executive further agrees that his fiduciary duties shall survive the termination of his employment for any reason.
- 13.2 The Executive further acknowledges and agrees that in performing the duties and responsibilities of his employment pursuant to this Agreement, he will become knowledgeable with respect to a wide variety of Confidential Information which is the exclusive property of the Company, the disclosure of which would cause irreparable harm to the Corporation. The Executive therefore agrees that during the Term and following the termination of the Executive's employment for any reason, he shall treat confidentially all Confidential Information belonging to the Corporation, and shall not disclose the Confidential Information to any unauthorized persons, except with the express consent of the Board of Directors, or otherwise as required by law.
- 13.3 In the event that this Agreement is terminated in accordance with Sections 9.1 or 10.2, the Executive acknowledges and agrees that during the Term and for a period following the Term equal to the Severance Period, he shall not for any reason, either directly or indirectly through any Person, agent, employee, Affiliate or representative:
- (a) solicit, entice or encourage, or attempt to solicit, entice or encourage, any employee, customer or exclusive supplier of the Corporation as at the Termination Date to become an employee, customer or exclusive supplier of any Person or enterprise that competes with the Business of the Corporation or a Related Corporation in the Western Canadian Sedimentary Basin, or any other exploration area in which the Corporation may conduct business.
  - (b) purchase, offer or agree to purchase, directly or indirectly, more than 5% of the outstanding securities of the Corporation or a Related Corporation or any material assets of the Corporation or a Related Corporation;

- (c) make, or in any way participate in, either directly or indirectly, any non-management solicitation of any proxy to vote or any consent with respect to any Shares;
  - (d) directly or indirectly make any public announcement with respect to any transaction involving the Corporation or any Related Corporation, or any securities or assets thereof;
  - (e) form, join or in any way participate in a group in connection with any of the foregoing;
  - (f) otherwise act, alone or in concert with others, to seek to control or influence the management or the Board of Directors or policies of the Corporation; or
  - (g) engage in any business that competes directly with the Business of the Corporation or any Related Corporation during the Term and for a period following the Term equal to the Severance Period. As used herein, the phrase “engaged in business” shall mean to act as an employee, agent, officer, director or consultant of a business or to be a sole proprietor, partner, joint venturer, unitholder, or owner of any other form of interest, of or in a business, but shall not include owning less than 1% of a public company which competes with the Corporation’s Business.
- 13.4 The Executive further acknowledges and agrees that pursuant to the terms of this Agreement, that to the extent he acquires Corporate Property of the Corporation, it shall remain the exclusive property of the Corporation. Upon termination of the Executive’s employment and this Agreement for any reason, the Executive shall return to the Corporation all Corporate Property, together with any copies or reproductions thereof; which may have come into the Executive’s possession during the course of or pursuant to this Agreement, and shall delete or destroy all computer files on his personal computer which may contain any Confidential Information belonging to the Corporation.
- 13.5 The Executive acknowledges and agrees that the Corporation will suffer irreparable harm in the event that the Executive breaches any of the obligations under this Article XIII, and that monetary damages would be impossible to quantify and inadequate to compensate the Corporation for such a breach. Accordingly, the Executive agrees that in the event of a breach, or a threatened breach, by the Executive of any of the provisions of this Article XIII, the Corporation shall be entitled to obtain, in addition to any other rights, remedies or damages available to the Corporation at law or in equity, an interim and permanent injunction, without having to prove damages, in order to prevent or restrain any such breach, or threatened breach, by the Executive, or by any or all of the Executive’s partners, employers, employees, servants, agents, representatives and any other Persons directly or indirectly acting for, or on behalf of; or with, the Executive, and that the Corporation shall be entitled to all of its costs and expenses incurred in obtaining such relief including reasonable solicitor and client legal costs and disbursements.
- 13.6 The Executive hereby agrees that all restrictions contained in this Article XIII are reasonable, valid and necessary protections of the Corporation’s proprietary business interests and hereby waives any and all defences to the strict enforcement thereof by the Corporation. If any covenant or provision of this Article XIII is determined to be void or unenforceable in whole or in part, for any reason, it shall be deemed not to affect or impair the validity of any other covenant or provision of this Agreement, which shall remain in full force and effect. The provisions of this Article XIII shall remain in full force and effect notwithstanding the termination of this Agreement for any reason.

#### **ARTICLE XIV INDEMNIFICATION AND INSURANCE**

- 14.1 Subject to the requirements of the Act, the Corporation shall indemnify and save harmless the Executive from and against any personal liability which he incurs as a direct result of performing his employment duties on behalf of the Corporation, with the exception of the following:
- (a) any liability arising from the Executive’s gross negligence or fraud or other acts of willful misfeasance; and

- (b) any liability which the Corporation is prohibited by law from assuming.
- 14.2 The Corporation agrees to maintain directors and officers liability insurance for the benefit of the Executive while the Executive remains an officer of the Corporation and shall, at the Executive's option or direction, provide such insurance for the Executive on a run-off basis upon termination of the Executive's employment with the Corporation pursuant to Section 9.1 and Articles X and XI only, for a period of three (3) years from the Termination Date, on commercially reasonable terms.
- 14.3 The provisions of this Article XIV shall remain in full force and effect notwithstanding the termination of this Agreement for any reason.

## **ARTICLE XV NOTICES**

- 15.1 Any Notice required to be given hereunder may be provided by personal delivery, by registered mail or by facsimile to the Parties hereto at the following addresses:

To the Corporation:

Canada Southern Petroleum Ltd.  
#250, 706 – 7<sup>th</sup> Avenue S.W.  
Calgary, AB T2P 0Z1

Attention: Chair of the Board

Or at its registered office as may be shown from time to time on the records of the Registrar of Companies for the Province of Nova Scotia.

To the Executive:

c/o Canada Southern Petroleum Ltd.  
#250, 706 – 7<sup>th</sup> Avenue S.W.  
Calgary, AB T2P 0Z1

Attention: J. W.A. McDonald

Any Notice, direction or other instrument shall, if delivered, be deemed to have been given and received on the business day on which it was so delivered, and if not a business day, then on the business day next following the day of delivery, and, if mailed, shall be deemed to have been given and received on the fifth day following the day on which it was so mailed, and, if sent by facsimile transmission, shall be deemed to have been given and received on the next business day following the day it was sent.

- 15.2 Either Party may change its address for Notice in the aforesaid manner.

## **ARTICLE XVI PRIVACY**

- 16.1 The Executive acknowledges and agrees that the Executive will take all necessary steps to protect and maintain personal information of the employees, consultants or customers of the Corporation obtained in the course of the Executive's employment with the Corporation. The Executive shall at all times comply, and shall assist the Corporation to comply, with all applicable privacy laws, including without limitation, the *Personal Information Protection Act* (Alberta) and the *Personal Information Protection and Electronic Documents Act* (Canada).

- 16.2 The Executive acknowledges and agrees that the disclosure of the Executive's personal information may be required as part of a potential business or commercial transaction or as part of the Corporation's management of the employment relationship, and the Executive hereby grants consent as may be required by applicable privacy laws to the disclosure of personal information for the purposes of any potential business or commercial transaction and the ongoing management of the employment relationship by the Corporation.

## **ARTICLE XVII GENERAL**

- 17.1 Time shall be of the essence in this Agreement.
- 17.2 This Agreement shall be construed and enforced in accordance with the laws of the Province of Alberta, and the Parties hereby attorn to the non-exclusive jurisdiction of Alberta Courts. Should provisions in this Agreement fail to comply with the applicable legislation, the Agreement shall be interpreted in accordance with those statutory requirements.
- 17.3 This Agreement and any other agreements expressly incorporated by reference herein, constitute the entire agreement between the Parties with respect to the subject matter hereof, and supercede and replace any and all prior agreements, undertakings, representations or negotiations pertaining to the subject matter of this Agreement. The Parties agree that they have not relied upon any verbal statements, representations, warranties or undertakings in order to enter into this Agreement. In the event of a conflict between this Agreement and any other agreement expressly incorporated by reference herein, the terms of this Agreement shall prevail.
- 17.4 This Agreement may not be amended or modified in any way except by written instrument signed by the Parties hereto.
- 17.5 This Agreement shall enure to the benefit of and be binding upon the Parties hereto, together with their personal representatives, successors and permitted assigns.
- 17.6 This Agreement is a personal services agreement and may not be assigned by either Party without the prior consent of the other Party.
- 17.7 The waiver by either Party of any breach of the provisions of this Agreement shall not operate or be construed as a waiver by that Party of any other breach of the same or any other provision of this Agreement.
- 17.8 The Parties agree to execute and deliver such further and other documents, and perform or cause to be performed such further and other acts and things as may be necessary or desirable in order to give full force and effect to this Agreement.
- 17.9 The Executive agrees that following the termination of the Executive's employment with the Corporation for any reason, the Executive shall tender his resignation from any position he may hold as an officer or director of the Corporation or any Related Corporation, or by virtue of those offices.
- 17.10 Should any provision in this Agreement be found to be invalid, illegal or unenforceable, the validity, legality or enforceability of the remaining provisions of the Agreement shall not be affected or impaired thereby in any way.

**ARTICLE XVIII**  
**EXECUTION IN COUNTERPART**

18.1 This Agreement may be executed by the Parties in counterpart.

**IN WITNESS WHEREOF** the Parties hereto acknowledge and agree that they have read and understand the terms of this Agreement, and that they have had an opportunity to seek independent legal advice prior to entering into this Agreement, and that they have executed this Agreement with full force and effect from the date first written above.

**CANADA SOUTHERN PETROLEUM LTD.**

Per: /s/ Richard C. McGinity  
Chairman of the Board of Directors

by /s/ Wilson Kwan  
Witness

by /s/ John W. A. McDonald  
**JOHN W.A. McDONALD**



**Exhibit 31.1**

**Canada Southern Petroleum Ltd.**

**Certification of Chief Executive Officer**

I, John W. A. McDonald, certify that:

1. I have reviewed this report on Form 10-Q of Canada Southern Petroleum Ltd. (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) (intentionally omitted pursuant to the guidance contained in SEC Release No. 33 – 8238)
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2004

by /s/ John W. A. McDonald  
John W. A. McDonald  
President and Chief Executive Officer

**Exhibit 31.2**

**Canada Southern Petroleum Ltd.**

**Certification of Chief Financial Officer**

I, Randy L. Denecky, certify that:

1. I have reviewed this report on Form 10-Q of Canada Southern Petroleum Ltd. (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) (intentionally omitted pursuant to the guidance contained in SEC Release No. 33 – 8238)
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2004

by /s/ Randy L. Denecky  
Randy L. Denecky  
Chief Financial Officer

**Exhibit 32**

**Canada Southern Petroleum Ltd.**

**Certification Pursuant to  
18 U.S.C. Section 1350,  
As Adopted Pursuant to  
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of Canada Southern Petroleum Ltd. (the "Company") on Form 10-Q for the period ended March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, John W. A. McDonald, Chief Executive Officer of the Company and Randy L. Denecky, Chief Financial Officer of the Company, do hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

by /s/ Randy L. Denecky  
Randy L. Denecky  
Chief Financial Officer

by /s/ John W. A. McDonald  
John W. A. McDonald  
President and Chief Executive Officer

Date: May 10, 2004

The foregoing certification is accompanying the Report solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), is not deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934 ("Exchange Act") and is not to be incorporated by reference into any filing of Canada Southern Petroleum Ltd. under the Securities Act of 1933 or the Exchange Act (whether made before or after the date of filing of the Report), irrespective of any general incorporation language contained in any such filing.