CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

THREE MONTHS ENDED MARCH 31, 2021 AND 2020

MANAGEMENT'S REPORT

To the Shareholders of Perpetual Energy Inc.

The accompanying unaudited condensed interim consolidated financial statements of Perpetual Energy Inc have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Chartered Professional Accountants of Canada for a review of interim financial statements by an entity's auditor.

The condensed interim consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards and are considered by management to present fairly the consolidated financial position, operating results and cash flows of the Company.

These condensed interim consolidated financial statements have been approved by the Audit Committee and the Board of Directors of the Company.

/s/ Susan L. Riddell Rose

Susan L. Riddell Rose
President &
Chief Executive Officer

/s/ Ryan A. Shay

Ryan A. Shay
Vice President, Finance &
Chief Financial Officer

May 4, 2021

PERPETUAL ENERGY INC.
Condensed Interim Consolidated Statements of Financial Position

As at	March 31, 2021	December 31, 2020
(*Cdn$ thousands unaudited*)		
Assets		
Current assets		
Accounts receivable (note 16)	**$ 3,831**	$ 3,953
Prepaid expenses and deposits	**854**	872
	4,685	4,825
Property, plant and equipment (note 4)	**119,015**	123,985
Exploration and evaluation (note 5)	**10,272**	10,272
Right-of-use assets (note 6)	**1,248**	1,372
Total assets	**$ 135,220**	$ 140,454
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**$ 11,423**	$ 11,924
Revolving bank debt (note 8)	**17,224**	17,495
Term loan (note 9)	**47,771**	46,691
Fair value of derivatives (note 18)	**2,937**	3,373
Royalty obligations (note 11)	**3,816**	3,553
Lease liabilities (note 12)	**708**	710
Decommissioning obligations (note 13)	**1,098**	1,048
	84,977	84,794
Senior notes (note 10)	**32,794**	32,359
Royalty obligations (note 11)	**2,073**	2,596
Lease liabilities (note 12)	**1,648**	1,791
Decommissioning obligations (note 13)	**29,161**	31,976
Total liabilities	**150,653**	153,516
Equity		
Share capital (note 14)	**97,616**	97,333
Contributed surplus	**45,269**	45,217
Deficit	**(158,318)**	(155,612)
Total equity	**(15,433)**	(13,062)
Total liabilities and equity	**$ 135,220**	$ 140,454

Future operations (note 1)
Contingencies (note 7)

See accompanying notes to the condensed interim consolidated financial statements.

/s/ Robert A. Maitland	*/s/ Geoffrey C. Merritt*
Robert A. Maitland	**Geoffrey C. Merritt**
Director	Director

PERPETUAL ENERGY INC.
Condensed Interim Consolidated Statements of Loss and Comprehensive Loss

	Three months ended March 31, 2021	2020
(Cdn$ thousands, except per share amounts, unaudited)		
Revenue		
Oil and natural gas (note 16)	**$ 11,536**	$ 10,497
Royalties	**(2,131)**	(2,383)
	9,405	8,114
Change in fair value of derivatives (note 18)	**(938)**	11,093
Gas over bitumen royalty credit	**238**	175
Other income (note 13)	**168**	–
	8,873	19,382
Expenses		
Production and operating	**3,286**	4,168
Transportation	**690**	1,270
Exploration and evaluation (note 5)	**20**	78
General and administrative	**2,055**	2,225
Share-based payments (note 15)	**480**	541
Depletion and depreciation (note 4 and 6)	**2,986**	6,279
Impairment (note 4(b) and 5)	**–**	60,500
Net loss from operating activities	**(644)**	(55,679)
Finance expense (note 17)	**(2,062)**	(3,135)
Change in fair value of TOU share investment (note 3)	**–**	(904)
Net loss and comprehensive loss	**(2,706)**	(59,718)
Net loss per share (note 14d)		
Basic and diluted	**$ (0.04)**	$ (0.98)

See accompanying notes to the condensed interim consolidated financial statements.

PERPETUAL ENERGY INC.
Condensed Interim Consolidated Statements of Changes in Equity

(Cdn$ thousands unaudited)	Share capital *(thousands)*	*($thousands)*	Warrants	Contributed surplus	Deficit	Total equity
Balance at December 31, 2020	61,305	$ 97,333	$ –	$ 45,217	$ (155,612)	$ (13,062)
Net loss	–	–	–	–	(2,706)	(2,706)
Common shares issued (note 14 and 15)	1,225	283	–	(53)	–	230
Change in shares held in trust (note 14 and 15)	–	–	–	–	–	–
Share-based payments (note 15)	–	–	–	105	–	105
Balance at March 31, 2021	**62,530**	**$ 97,616**	**$ –**	**$ 45,269**	**$ (158,318)**	**$ (15,433)**

(Cdn$ thousands unaudited)	Share capital *(thousands)*	*($thousands)*	Warrants	Contributed surplus	Deficit	Total equity
Balance at December 31, 2019	60,513	$ 96,876	$ 923	$ 44,234	$ (94,015)	$ 48,018
Net loss	–	–	–	–	(59,718)	(59,718)
Common shares issued (note 14 and 15)	–	–	(923)	923	–	–
Change in shares held in trust (note 14 and 15)	204	98	–	(98)	–	–
Share-based payments (note 15)	–	–	–	180	–	180
Balance at March 31, 2020	**60,717**	**$ 96,974**	**$ –**	**$ 45,239**	**$ (153,733)**	**$ (11,520)**

See accompanying notes to the condensed interim consolidated financial statements.

PERPETUAL ENERGY INC.
Condensed Interim Consolidated Statements of Cash Flows

(*Cdn$ thousands, unaudited*)	Three months ended March 31, **2021**	2020
Cash flows from (used in) operating activities		
Net loss	**$ (2,706)**	$ (59,718)
Adjustments to add (deduct) non-cash items:		
Other income (note 13)	**(168)**	–
Depletion and depreciation (note 4 and 6)	**2,986**	6,279
Exploration and evaluation (note 5)	**–**	36
Share-based payments (note 15)	**105**	180
Unrealized change in fair value of derivatives (note 18)	**(436)**	(12,143)
Change in fair value of TOU share investment (note 3)	**–**	904
Finance expense (note 17)	**2,999**	565
Impairment (note 4(b) and 5)	**–**	60,500
Oil and natural gas revenue in-kind (note 11)	**(1,133)**	–
Decommissioning obligations settled (note 13)	**(115)**	(174)
Payments of restructuring costs	**–**	(478)
Change in non-cash working capital	**150**	935
Net cash flows from (used in) operating activities	**1,682**	(3,114)
Cash flows from (used in) financing activities		
Change in revolving bank debt, net of issue costs (note 8)	**(329)**	(8,464)
Change in TOU share margin demand loan, net of issue costs	**–**	(100)
Change in senior notes, net of issue costs (note 10)	**(219)**	–
Payments of lease liabilities (note 12)	**(145)**	(123)
Payments of gas over bitumen royalty financing (note 11)	**(236)**	(204)
Common shares issues, net of issue costs	**230**	–
Net cash flows used in financing activities	**(699)**	(8,891)
Cash flows from (used in) investing activities		
Capital expenditures	**(3)**	(5,233)
Acquisitions (note 4)	**(625)**	–
Net proceeds from dispositions (note 4(a))	**156**	–
Proceeds from sale of TOU share investment (note 3)	**–**	14,316
Change in non-cash working capital	**(511)**	2,922
Net cash flows from (used in) investing activities	**(983)**	12,005
Change in cash and cash equivalents	**–**	–
Cash and cash equivalents, beginning of period	**–**	–
Cash and cash equivalents, end of period	**$ –**	$ –

See accompanying notes to the condensed interim consolidated financial statements.

1. REPORTING ENTITY

Perpetual Energy Inc. ("Perpetual" or the "Company") is an oil and natural gas exploration, production, and marketing company headquartered in Calgary, Alberta. Perpetual owns a diversified asset portfolio, including liquids-rich conventional natural gas assets in the deep basin of West Central Alberta, heavy crude oil and shallow conventional natural gas in Eastern Alberta, and undeveloped bitumen leases in Northern Alberta.

The address of the Company's registered office is 3200, 605 – 5 Avenue S.W., Calgary, Alberta, T2P 3H5.

The condensed interim consolidated financial statements of the Company as at and for the three months ended March 31, 2021 are comprised of the accounts of Perpetual Energy Inc. and its wholly owned subsidiaries: Perpetual Operating Corp. and Perpetual Operating Trust, which are incorporated in Alberta.

Future operations

On April 1, 2020, the Company sold a 50% working interest in its East Edson property in West Central Alberta to a third party (the "Purchaser") for consideration including a cash payment of $35 million and the carried interest funding of the drill, complete and tie-in costs for an eight well drilling program (the "East Edson Transaction") (note 4(a)). Net proceeds were used to repay a portion of the reserve-based credit facility ("Credit Facility") (note 8). Effective April 1, 2020, Perpetual's syndicate of Credit Facility lenders completed their borrowing base redetermination, reducing the Credit Facility borrowing limit (the "Borrowing Limit") from $45 million to $20 million after incorporating the impact of the East Edson Transaction. As at March 31, 2021, $17.2 million was borrowed and $0.9 million of letters of credit were issued on the Credit Facility, and the Company had a net working capital deficiency (accounts payable and accrued liabilities, less accounts receivable and prepaid expenses and deposits) of $6.7 million.

The Company will require additional financing to fund the net working capital deficiency, and to refinance the upcoming Credit Facility and second lien term loan (the "Term Loan") maturities as the available liquidity and operating cash flows are not anticipated to be sufficient. The semi-annual Term Loan interest payment of $1.8 million that was payable December 31, 2020, was deferred by the Company's lender and added to the principal amount owing as a condition of the Credit Facility lenders agreeing to extend the Credit Facility maturity. In January 2021, the Company exchanged its $33.6 million 8.75% unsecured senior notes due January 23, 2022 (the "2022 Senior Notes") for new $33.6 million secured 8.75% third lien senior notes due January 23, 2025 (the "2025 Senior Notes"). Interest on the 2025 Senior Notes may be paid-in-kind at the option of the Company by adding the interest payment to the principal amount owing. On January 23, 2021, the $1.5 million semi-annual interest payment on the 2025 Senior Notes was paid in-kind, increasing the principal amount outstanding to $35.0 million (note 10). The Company intends to satisfy the semi-annual interest payment due July 23, 2021 by making an in-kind payment.

On March 1, 2021, the Borrowing Limit redetermination and maturity date for the Credit Facility was extended from March 1, 2021 to April 30, 2021, and on April 30, 2021, the Borrowing Limit redetermination and maturity date was further extended to June 16, 2021. If not extended by June 16, 2021, the Credit Facility will cease to revolve, and all outstanding advances will be repayable. On April 30, 2021, the maturity date applicable to the Company's $47.8 million Term Loan was extended from May 14, 2021 to June 30, 2021. The extension of the Company's Credit Facility and Term Loan maturities provides additional time to finalize negotiations with its lenders and for the Company to explore opportunities to enhance its liquidity. The Company remains dependent on the support of its lenders to extend approaching maturities. Although cash flows from operations are forecasted to improve for the next twelve-month period, Perpetual is considering other options including the extension of existing debt maturity dates, alternative financing, and the sale or monetization of additional assets.

Due to the facts and circumstances detailed above, coupled with considerable economic instability and uncertainty in the oil and gas industry which negatively impacts operating cash flows and lender and investor sentiment, there remains considerable risk around the Company's ability to address its liquidity shortfalls and upcoming maturities. In addition, there continues to be some uncertainty regarding the Statement of Claim (note 7) which may restrict the Company's ability to manage its capital structure. As a result, there is material uncertainty surrounding the Company's ability to continue as a going concern that creates significant doubt as to the ability of the Company to meet its obligations as they come due. Therefore, the Company may be unable to realize its assets and discharge its liabilities in the normal course of business.

These financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Corporation will be able to realize its assets and discharge its liabilities in the normal course of business. These financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses, and the balance sheet classifications used. These adjustments could be material.

2. BASIS OF PREPARATION

These condensed interim consolidated financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting and do not include all of the information required for full annual financial statements. These condensed interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements as at and for the year ended December 31, 2020 which were prepared in conformity with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board.

The accounting policies, basis of measurement, critical accounting judgements and significant estimates used to prepare the annual consolidated financial statements as at and for the year ended December 31, 2020 have been applied in the preparation of these condensed interim consolidated financial statements.

These condensed interim consolidated financial statements of the Company were approved and authorized for issue by the Board of Directors on May 4, 2021.

3. TOURMALINE OIL CORP. ("TOU") SHARE INVESTMENT

	December 31, 2020	
	Shares *(thousands)*	Amount *($thousands)*
Balance, beginning of year	1,000	$ 15,220
Sold	(1,000)	(14,316)
Change in fair value of TOU share investment	–	(904)
Balance, end of year	–	$ –

During the year ended December 31, 2020, the Company sold the remaining 1,000,000 TOU shares at a weighted average price of $14.32 per share for net cash proceeds of $14.3 million. Proceeds were used to repay the $0.1 million TOU share margin demand loan in full and to pay down a portion of the Credit Facility (note 8).

4. PROPERTY, PLANT AND EQUIPMENT ("PP&E")

	Oil and Gas Properties	**Corporate Assets**	**Total**
Cost			
December 31, 2019	$ 731,526	$ 7,688	$ 739,214
Additions	5,884	(36)	5,848
Drilling program rights (a)	18,000	–	18,000
Acquisitions	222	–	222
Change in decommissioning obligations related to PP&E (note 13)	2,747	–	2,747
Transfers from exploration and evaluation (note 5)	252	–	252
Dispositions (a)	(193,672)	–	(193,672)
December 31, 2020	$ 564,959	$ 7,652	$ 572,611
Additions	1	2	3
Acquisitions	625	–	625
Change in decommissioning obligations related to PP&E (note 13)	(2,580)	–	(2,580)
Dispositions	(156)	–	(156)
March 31, 2021	**$ 562,849**	**$ 7,654**	**$ 570,503**
Accumulated depletion and depreciation			
December 31, 2019	$ (537,149)	$ (7,431)	$ (544,580)
Depletion and depreciation	(14,926)	(136)	(15,062)
Impairment (b)	(32,300)	–	(32,300)
Dispositions (a)	143,316	–	143,316
December 31, 2020	$ (441,059)	$ (7,567)	$ (448,626)
Depletion and depreciation	(2,845)	(17)	(2,862)
March 31, 2021	**$ (443,904)**	**$ (7,584)**	**$ (451,488)**
Carrying amount			
December 31, 2020	$ 123,900	$ 85	$ 123,985
March 31, 2021	**$ 118,945**	**$ 70**	**$ 119,015**

At March 31, 2021, property, plant and equipment included $1.0 million (December 31, 2020 – $1.0 million) of costs currently not subject to depletion.

a) Dispositions

On April 1, 2020, the Company sold a 50% working interest in its East Edson property in West Central Alberta to the Purchaser. The consideration received, and calculation of the gain (loss) recorded on disposition is summarized below:

($ thousands)	
Cash proceeds from disposition (i)	**34,750**
Drilling program rights received (ii)	**18,000**
Retained East Edson royalty obligation (iii)	**(6,996)**
Carrying amount of PP&E and E&E disposed (iv)	**(52,803)**
Carrying amount of decommissioning obligations disposed (v)	**7,049**
Gain (loss) on disposition	**–**

i)	Cash proceeds from disposition	$35.0 million of cash received on closing, net of $0.2 million of transaction costs and closing adjustments. In order to reflect the nature of the proceeds received, cash proceeds from disposition have been allocated on the condensed interim consolidated statements of cash flows to financing and investing activities in the amount of $7.0 million and $27.8 million, respectively.
ii)	Drilling program rights received	$18.0 million of drilling program rights, comprised of the carried interest funding of the drill, complete, and tie-in costs for an eight-well drilling program. Seven horizontal wells targeting development of the Wilrich formation were drilled, completed and have commenced production. Drilling program rights have been subject to depletion. The Purchaser is required to fulfill its entire commitment by April 1, 2022 and will be obligated to pay Perpetual $2.25 million for each commitment well not completed and having commenced production by this time.
iii)	Retained East Edson royalty obligation	$7.0 million that Perpetual will retain until December 31, 2022 on behalf of the Purchaser, comprising the fair value of the Purchaser's 50% working interest in the existing gross overriding royalty on the East Edson property equivalent to 2.8 MMcf/d of conventional natural gas and associated natural gas liquids ("NGL") production (note 11).
iv)	Carrying amount of PP&E and E&E disposed	$52.8 million comprised of oil and gas properties ($50.4 million) and exploration and evaluation assets ($2.4 million).
v)	Carrying amount of decommissioning obligations disposed	$7.0 million of decommissioning obligations associated with oil and gas properties disposed.

b) Cash-generating units ("CGUs") and impairment

The Company is required to assess when internal or external indicators of impairment or impairment reversal exist, and impairment testing is required. At March 31, 2021, the Company conducted an assessment of indicators of impairment and impairment reversal for all the Company's CGUs. There were no triggers identified and therefore, no impairments or impairment reversals recognized during the first quarter of 2021.

For the year ended December 31, 2020, the Company has recorded an aggregate non-cash impairment charge of $32.3 million related to the CGUs in net loss.

At December 31, 2020, the Company determined that the estimated recoverable amounts of the West Central CGU and Eastern Alberta CGU exceeded the carrying amounts of $81.2 million and $24.7 million, respectively. Accordingly, an aggregate non-cash impairment reversal of $18.0 million was included in net loss.

At March 31, 2020, the Company determined that the carrying amounts of the West Central CGU and Eastern Alberta CGU exceeded the estimated recoverable amounts of $66.3 million and $26.4 million, respectively. Accordingly, an aggregate non-cash impairment charge of $50.3 million was included in net loss.

5. EXPLORATION AND EVALUATION ("E&E")

	March 31, 2021	December 31, 2020
Balance, beginning of period	**$ 10,272**	$ 23,609
Additions	**–**	91
Dispositions	**–**	(2,447)
Impairments	**–**	(10,200)
Non-cash exploration and evaluation expense	**–**	(529)
Transfers to property, plant and equipment	**–**	(252)
Balance, end of period	**$ 10,272**	$ 10,272

During the three months ended March 31, 2021, a nominal amount (Q1 2020 – a nominal amount) was charged directly to E&E expense in the condensed interim consolidated statements of loss and comprehensive loss.

During the year ended December 31, 2020, the Company and its President and Chief Executive Officer ("CEO") acquired undeveloped lands from third parties in its Eastern Alberta core area. The Company has the option, but not the obligation, to acquire the CEO's interest in the acquired lands for a pre-determined amount, prior to July 1, 2021.

Impairment of E&E assets

E&E assets are tested for impairment both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to oil and gas properties in PP&E.

At March 31, 2021, the Company conducted an assessment of indicators of impairment and impairment reversal for the Company's E&E assets. There were no triggers identified and therefore, no impairments or impairment reversals recognized during the first quarter of 2021.

At March 31, 2020, the Company determined that the carrying amount of E&E assets exceeded the estimated recoverable amount and accordingly, a non-cash impairment charge of $10.2 million was included in net loss.

6. RIGHT-OF-USE ASSETS

The Company leases several assets including office space, vehicles, and other leases. Information about leases for which the Company is a lessee is presented below:

	Head office	Vehicles	Other leases	Total
Cost				
January 1, 2020	$ 1,498	$ 200	$ 161	$ 1,859
Additions	93	189	86	368
December 31, 2020	$ 1,591	$ 389	$ 247	$ 2,227
Additions	–	–	–	–
March 31, 2021	**$ 1,591**	**$ 389**	**$ 247**	**$ 2,227**
Accumulated depreciation				
January 1, 2020	$ (240)	$ (80)	$ (64)	$ (384)
Depreciation	(257)	(135)	(79)	(471)
December 31, 2020	$ (497)	$ (215)	$ (143)	$ (855)
Depreciation	(65)	(36)	(23)	(124)
March 31, 2021	**$ (562)**	**$ (251)**	**$ (166)**	**$ (979)**
Carrying amount				
December 31, 2020	$ 1,094	$ 174	$ 104	$ 1,372
March 31, 2021	**$ 1,029**	**$ 138**	**$ 81**	**$ 1,248**

7. CONTINGENCIES

On August 3, 2018, the Company received a Statement of Claim that was filed by PricewaterhouseCoopers Inc. LIT ("PwC"), in its capacity as trustee in bankruptcy (the "Trustee") of Sequoia Resources Corp. ("Sequoia"), with the Alberta Court of Queen's Bench (the "Court"), against Perpetual (the "Sequoia Litigation"). The claim relates to an over four-year-old transaction when, on October 1, 2016, Perpetual closed the disposition of shallow conventional natural gas assets in Eastern Alberta to an arm's length third party at fair market value at the time after an extensive and lengthy marketing, due diligence and negotiation process (the "Sequoia Disposition"). This transaction was one of several completed by Sequoia. Sequoia assigned itself into bankruptcy on March 23, 2018. PwC is seeking an order from the Court to either set this transaction aside or declare it void, or damages of approximately $217 million. On August 27, 2018, Perpetual filed a Statement of Defence and Application for Summary Dismissal with the Court in response to the Statement of Claim. All allegations made by PwC have been denied and an application to the Court to dismiss all claims has been made on the basis that there is no merit to any of them.

On January 13, 2020, the Court issued its written decision related to the Sequoia Disposition. The decision dismissed and struck all claims against the Company's CEO and all but one of the claims filed against Perpetual. The Court did not find that the test for summary dismissal relating to whether the asset transaction was an arm's length transfer for purposes of section 96(1) of the Bankruptcy and Insolvency Act (the "BIA") was met, on the balance of probabilities. Accordingly, the BIA claim was not dismissed or struck and only that part of the claim could continue against Perpetual. The Trustee filed a notice of appeal with the Court of Appeal of Alberta, challenging the entire decision, and Perpetual filed a similar notice of appeal contesting the BIA claim portion of the decision (the "First Appeal").

The First Appeal proceedings were heard on December 10, 2020. On January 25, 2021, the Court of Appeal of Alberta issued their judgement with respect to the First Appeal proceedings, dismissing the appeal filed by Perpetual and granting certain aspects of the appeals filed by the Trustee, thereby reinstating certain elements of the Sequoia Litigation for trial. On March 24, 2021, Perpetual applied for leave to appeal the First Appeal decision to the Supreme Court of Canada.

On February 25, 2020, Perpetual filed a second application to strike and summarily dismiss the BIA claim on the basis that there was no transfer at undervalue, and Sequoia was not insolvent at the time of the asset transaction nor caused to be insolvent by the asset transaction. In July 2020, the Orphan Well Association ("OWA"), certain oil and gas companies, and six municipalities applied to intervene in the second BIA dismissal application proceedings. The OWA and certain oil and gas companies were permitted to intervene (the "Intervenors") in the proceedings which took place on October 1 and 2, 2020. The Intervenors were also permitted to intervene in the First Appeal proceedings. On January 14, 2021 the Court issued its decision, finding that the Trustee could not establish a necessary element of the BIA Claim as Sequoia was not insolvent at the time of, nor rendered insolvent by, the Sequoia Disposition. The Court therefore concluded there is "no merit" to the BIA Claim and it summarily dismissed the balance of the Statement of Claim. The Trustee has subsequently appealed this decision.

Management expects that the Company is more likely than not to be completely successful in defending against the Sequoia Litigation such that no damages will be awarded against it, and therefore, no amounts have been accrued as a liability in these financial statements.

8. REVOLVING BANK DEBT

As at March 31, 2021, the Company's Credit Facility had a Borrowing Limit of $20.0 million (December 31, 2020 – $20.0 million) under which $17.2 million was drawn (December 31, 2020 – $17.5 million) and $0.9 million of letters of credit had been issued (December 31, 2020 – $0.9 million). Borrowings under the Credit Facility bear interest at its lenders' prime rate or Banker's Acceptance rates, plus applicable margins and standby fees. The applicable Banker's Acceptance margins range between 3.0% and 5.5%. The effective interest rate on the Credit Facility at March 31, 2021 was

5.9%. For the period ended March 31, 2021 if interest rates changed by 1% with all other variables held constant, the impact on annual cash finance expense and net loss would be $0.2 million.

On March 1, 2021, the Borrowing Limit redetermination and maturity date was extended to April 30, 2021, and on April 30, 2021, the Borrowing Limit redetermination and maturity date was extended to June 16, 2021. If not extended by June 16, 2021, the Credit Facility will cease to revolve, and all outstanding advances will be repayable. As a result, revolving bank debt has been presented as a current liability on the condensed interim consolidated statements of financial position as at March 31, 2021.

The Credit Facility is secured by general, first lien security agreements covering all present and future property of the Company and its subsidiaries, with the exception of certain lands pledged to the gas over bitumen royalty financing counterparty. The Credit Facility also contains provisions which restrict the Company's ability to repay Term Loan and senior note principal and interest, and to pay dividends on or repurchase its common shares.

At March 31, 2021, the Credit Facility was not subject to any financial covenants and the Company was in compliance with all customary non-financial covenants.

9. TERM LOAN

			March 31, 2021		December 31, 2020	
	Maturity date	**Interest rate**	**Principal**	**Carrying Amount**	Principal	Carrying amount
Term loan	May 14, 2021	8.1%	**$ 47,771**	**$ 47,771**	$ 46,823	$ 46,691

The Term Loan bears a fixed interest rate of 8.1%, with semi-annual interest payments due June 30th and December 31st of each year. In the fourth quarter of 2020, the Company and lender reached an agreement, allowing outstanding interest amounts of $1.8 million related to the December 31st payment to be paid-in-kind and added to the outstanding principal amount of the loan. On March 9, 2021, the maturity date applicable to the Company's Term Loan was extended from March 14, 2021 to May 14, 2021, and the lender has allowed accrued interest to be paid in-kind and added to the principal amount of the loan. Non-cash paid in-kind interest of $0.9 million has been recorded in the first quarter of 2021, increasing the principal amount owing at March 31, 2021 to $47.8 million. On April 30, 2021, the maturity date applicable to the Company's $47.8 million second lien Term Loan was extended from May 14, 2021 to June 30, 2021.

The Term Loan has been presented as a current liability on the condensed interim consolidated statements of financial position as at March 31, 2021.

The Term Loan has a cross-default provision with the Credit Facility and contains substantially similar provisions and covenants as the Credit Facility (note 8). The Term Loan is secured by a general security agreement over all present and future property of the Company and its subsidiaries on a second priority basis, subordinate only to liens securing loans under the Credit Facility, and certain lands pledged to the gas over bitumen royalty financing counterparty (note 11).

At March 31, 2021, the Term Loan was not subject to any financial covenants and the Company was in compliance with all customary non-financial covenants.

10. SENIOR NOTES

			March 31, 2021		December 31, 2020	
	Maturity date	**Interest rate**	**Principal**	**Carrying Amount**	Principal	Carrying amount
Senior notes	January 23, 2025	8.75%	**$ 35,637**	**$ 32,794**	$ 33,580	$ 32,359

On January 22, 2021, Perpetual announced the completion of a Court-approved plan of arrangement whereby the unsecured 2022 Senior Notes were exchanged for new 8.75% secured third lien notes due January 23, 2025. The 2025 Senior Notes have been issued under a trust indenture that contains substantially the same terms as the 2022 Senior Notes, other than the 2025 Senior Notes are secured on a third lien basis and allow for the semi-annual interest payments to be paid at Perpetual's option, in cash, or in additional 2025 Senior Notes (a "PIK Interest Payment"). The Company elected to pay the January 23, 2021 semi-annual interest of $1.5 million by a PIK Interest Payment which increased the principal amount of the 2025 Senior Notes outstanding to $35.0 million, and intends to satisfy the semi-annual interest payment due July 23, 2021 by making a PIK Interest Payment. Non-cash paid in-kind interest of $0.8 million has been recorded in the first quarter of 2021, increasing the principal amount owing at March 31, 2021 to $35.6 million.

At March 31, 2021, the senior notes are recorded at the present value of future cash flows, net of $2.8 million in issue and principal discount costs, which includes a net gain recorded on the senior note maturity extension of $1.6 million, representing the difference between the carrying amount of 2022 Senior Notes of $34.5 million and the present value of the modified cash flows for the 2025 Senior Notes of $32.9 million. The gain has been recorded as a reduction of non-cash finance expense (note 17). Issue and principal discount costs are amortized over the remaining term using a weighted average effective interest rate of 11.4%.

The senior notes are direct senior secured, third lien obligations of the Company. The Company may redeem the senior notes without any repayment penalty. The senior notes have a cross-default provision with the Company's Credit Facility. In addition, the senior notes indenture contains restrictions on certain payments including dividends, retirement of subordinated debt, and stock repurchases. At March 31, 2021, the senior notes were not subject to any financial covenants and the Company was in compliance with all customary non-financial covenants.

Entities controlled by the Company's CEO hold $15.2 million of the 2025 Senior Notes outstanding. An entity that is associated with the Company's CEO, and an entity that is associated with a Director of the Company hold an additional $9.5 million and $0.7 million of the 2025 Senior Notes outstanding, respectively.

11. ROYALTY OBLIGATIONS

	Retained East Edson royalty obligation	Gas over bitumen royalty financing	Total
December 31, 2019	–	871	871
Initial recognition (note 4(a))	6,996	–	6,996
Cash payments	–	(704)	(704)
Non-cash payments in-kind	(2,319)	–	(2,319)
Change in fair value (note 17)	1,037	268	1,305
December 31, 2020	5,714	435	6,149
Cash payments	–	(236)	(236)
Non-cash payments in-kind	(1,133)	–	(1,133)
Change in fair value (note 17)	1,023	86	1,109
March 31, 2021	**5,604**	**285**	**5,889**

	March 31, 2021	December 31, 2020
Current	**$ 3,816**	$ 3,553
Non-current	**2,073**	2,596
Total royalty obligations	**$ 5,889**	$ 6,149

The retained East Edson royalty obligation formed part of the net consideration received by Perpetual from the East Edson Transaction whereby Perpetual agreed to retain the Purchaser's 50% working interest in the existing gross overriding royalty obligation on the property, equivalent to 2.8 MMcf/d of natural gas and associated NGL production for the period April 1, 2020 to December 31, 2022 (see note 4(a)(iii)). The retained East Edson royalty obligation is paid in-kind and settled through non-cash delivery of contractual natural gas and NGL volumes to the royalty holder (note 16).

The Company has designated the retained East Edson royalty obligation and the gas over bitumen royalty financing as financial liabilities which are measured at fair value through profit and loss, estimated by discounting future royalty obligations based on forecasted natural gas and NGL commodity prices multiplied by the royalty obligation volumes. For the three months ended March 31, 2021, an unrealized loss of $1.1 million (2020 – unrealized loss of $1.3 million) is included in non-cash finance expense related to the change in fair value of total royalty obligations (note 17).

As at March 31, 2021, if forecasted natural gas commodity prices changed by $0.25 per GJ with all other variables held constant, the fair value of the total royalty obligations and net loss for the period would change by $0.5 million.

12. LEASE LIABILITIES

	March 31, 2021	December 31, 2020
Balance, beginning of period	**$ 2,501**	$ 2,685
Additions	**–**	368
Interest on lease liabilities (note 17)	**40**	175
Payments	**(185)**	(727)
Total lease liabilities	**$ 2,356**	$ 2,501
Current	**$ 708**	$ 710
Non-current	**1,648**	1,791
Total lease liabilities	**$ 2,356**	$ 2,501

Lease terms are negotiated on an individual basis and contain a wide range of terms and conditions. Incremental borrowing rates used to measure the present value of the future lease payments at March 31, 2021 were between 4.3% and 6.6% (2020 – 4.3% and 6.6%).

13. DECOMMISSIONING OBLIGATIONS

The following significant assumptions were used to estimate decommissioning obligations:

	March 31, 2021	December 31, 2020
Obligations incurred, including acquisitions	**$ 116**	$ 603
Change in risk free interest rate	**(2,696)**	2,344
Change in estimates	**–**	(200)
Change in decommissioning obligations related to PP&E (note 4)	**(2,580)**	2,747
Obligations settled (cash)	**(115)**	(210)
Obligations settled[(1)] (non-cash)	**(168)**	(812)
Obligations disposed (note 4(a)(v))	**–**	(7,049)
Accretion (note 17)	**98**	443
Change in decommissioning obligations	**(2,765)**	(4,881)
Balance, beginning of period	**33,024**	37,905
Balance, end of period	**$ 30,259**	$ 33,024
Decommissioning obligations – current	**$ 1,098**	$ 1,048
Decommissioning obligations – non-current	**29,161**	31,976
Total decommissioning obligations	**$ 30,259**	$ 33,024

(1) Obligations settled (non-cash) of $0.2 million (2020 – $0.8 million) were funded by payments made directly to Perpetual's service providers from the Alberta Site Rehabilitation Program. These amounts have been recorded as other income.

Decommissioning obligations are estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities, and the estimated timing of the costs to be incurred in future periods.

The increase in the provision due to the passage of time, which is referred to as accretion, is recognized as non-cash finance expense in the condensed interim consolidated statements of loss and comprehensive loss. Decommissioning obligations are further adjusted at each period end date for changes in the risk-free interest rate, after considering additions and dispositions of PP&E. Decommissioning obligations are also adjusted for revisions to future cost estimates and the estimated timing of costs to be incurred in future periods.

The following significant assumptions were used to estimate the Company's decommissioning obligations:

	March 31, 2021	December 31, 2020
Undiscounted obligations	**$ 31,511**	$ 31,683
Average risk-free rate	**2.0%**	1.2%
Inflation rate	**1.7%**	1.5%
Expected timing of settling obligations	**1 to 25 years**	1 to 25 years

14. SHARE CAPITAL

	March 31, 2021		December 31, 2020	
	Shares *(thousands)*	**Amount *($thousands)***	Shares *(thousands)*	Amount *($thousands)*
Balance, beginning of period	**61,305**	**$ 97,333**	60,513	$ 96,876
Issued pursuant to share-based payment plans	**225**	**53**	548	340
Shares held in trust issued (b)	**–**	**–**	244	117
Treasury shares issued (c)	**1,000**	**230**	–	–
Balance, end of period	**62,530**	**$ 97,616**	61,305	$ 97,333

a) Authorized

Authorized capital consists of an unlimited number of common shares.

b) Shares held in trust

The Company has compensation agreements in place with employees whereby they may be entitled to receive shares of the Company purchased on the open market by a trustee (note 15). Share capital is presented net of the number and cumulative purchase cost of shares held by the trustee that have not yet been issued to employees. As at March 31, 2021, 0.6 million shares were held in trust (December 31, 2020 – 0.6 million).

c) Treasury shares issued

During the first quarter of 2021, 1.0 million common shares were issued to an Officer of the Company for $0.2 million of cash consideration at a price of $0.23 per share, representing the volume weighted average trading price of the shares for the 5 day period immediately preceding the issuance.

d) Per share information

	Three months ended March 31, 2021	2020
(thousands, except per share amounts)		
Net loss – basic	**$ (2,706)**	$ (59,718)
Effect of dilutive securities	**–**	–
Net loss – diluted	**$ (2,706)**	$ (59,718)
Weighted average shares		
Issued common shares	**62,159**	61,313
Effect of shares held in trust	**(556)**	(639)
Weighted average common shares outstanding – basic and diluted	**61,603**	60,674
Net loss per share – basic and diluted	**$ (0.04)**	$ (0.98)

In computing per share amounts for the three months ended March 31, 2021, 18.2 million potentially issuable common shares through the share-based payment plans (Q1 2020 – 11.9 million) were excluded as the Company had a net loss.

15. SHARE-BASED PAYMENTS

The components of share-based payment expense are as follows:

	Three months ended March 31, 2021	2020
Share options	**$ 29**	$ 86
Restricted rights	**–**	–
Performance share rights	**413**	411
Compensation awards	**38**	44
Share-based payments	**$ 480**	$ 541

The following tables summarize information about options, rights, and awards outstanding:

	Compensation awards					
(thousands)	**Deferred options**	**Deferred shares**	**Share options**	**Performance share rights[1]**	**Restricted rights**	**Total**
December 31, 2019	3,587	1,276	4,604	2,745	–	12,212
Granted	2,250	1,571	873	1,710	557	6,961
Exercised for common shares	–	–	–	–	(548)	(548)
Exercised for shares held in trust	–	(244)	–	–	–	(244)
Exercised for restricted rights	–	(40)	–	(517)	–	(557)
Performance adjustment	–	–	–	(518)	–	(518)
Cancelled/forfeited	(754)	(162)	–	–	(9)	(925)
Expired	(26)	–	(80)	–	–	(106)
December 31, 2020	5,057	2,401	5,397	3,420	–	16,275
Granted[2][3]	–	136	350	1,715	233	2,434
Exercised for common shares	–	–	–	–	(225)	(225)
Exercised for restricted rights	–	(233)	–	–	–	(233)
Cancelled/forfeited	–	–	–	–	(8)	(8)
Expired	–	(20)	–	–	–	(20)
March 31, 2021	**5,057**	**2,284**	**5,747**	**5,135**	**–**	**18,223**

(1) Certain performance share rights contain monetary awards that may be settled in cash, in common shares of the Company, or a combination thereof at the discretion of the Board of Directors, equal to the monetary amount at the time of vesting. These awards are accounted for as cash-settled share-based payments in which the fair value of the amounts payable under the plan are recognized incrementally as an expense over the vesting period, with a corresponding change in liabilities. As at March 31, 2021, $0.8 million had been accrued pursuant to cash-settled share-based payment awards (December 31, 2020 – $0.4 million).

(2) Share options granted during the three months ended March 31, 2021 have an exercise price of $0.23 and vest evenly over four years, with expiry occurring five years after issuance. The Company used the Black Scholes option pricing model to calculate the estimated fair value of the outstanding deferred options and share options at the date of grant. Expected volatility of 60% and forfeiture rates of 5% were used to value the share options.

(3) During the first quarter of 2021, 0.4 million share options, 1.7 million performance share rights, and 0.1 million deferred shares were granted to Officers and Directors of the Company.

16. REVENUE

The Company sells its production pursuant to fixed or variable price contracts. The transaction price for variable priced contracts is based on the commodity price, adjusted for quality, location or other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. Under the contracts, the Company is required to deliver fixed or variable volumes of conventional natural gas, heavy crude oil or NGL as may be applicable to the contract counterparty. Revenue is recognized when a unit of production is delivered to the contract counterparty. The amount of revenue recognized is based on the agreed transaction price, whereby any variability in revenue relates specifically to the Company's efforts to transfer production, and therefore the resulting revenue is allocated to the production delivered in the period during which the variability occurs. As a result, none of the variable revenue is considered constrained.

Conventional natural gas, heavy crude oil and NGL are mostly sold under contracts of varying price and volume terms of up to one year. Revenues are typically collected on the 25th day of the month following production.

Natural gas volumes sold pursuant to the Company's market diversification contract are sold at fixed volume obligations and priced at daily index prices plus US$0.02/MMBtu until October 31, 2022 and less US$0.08/MMBtu thereafter, less transportation costs from AECO to each market price point as detailed in the table below.

In the first quarter of 2021, the Company reduced its fixed volume obligations by 10,000 MMBtu/d for the period commencing April 1, 2021 and ending on October 31, 2021 in consideration for the payment of $1.4 million over the term of the associated contract volumes. The amount was recognized as a realized loss on derivatives (note 18).

Market/Pricing Point	**November 1, 2020 to March 31, 2021 Daily sales volume *(MMBtu/d)***	**April 1, 2021 to October 31, 2021 Daily sales volume *(MMBtu/d)***	**November 1, 2021 to October 31, 2022 Daily sales volume *(MMBtu/d)***	**November 1, 2022 to October 31, 2024 Daily sales volume *(MMBtu/d)***
Chicago	4,000	–	12,200	–
Malin	–	–	–	15,000
Dawn	6,000	–	8,000	15,000
Michcon	–	–	5,200	–
Empress	–	–	–	–
Emerson	–	–	–	10,000
Total sales volume obligation	**10,000**	**–**	**25,400**	**40,000**

Subsequent to March 31, 2021, the Company eliminated its 25,400 MMBtu/d market diversification contract obligations for the period commencing November 1, 2021 and ending on March 31, 2022 in consideration for the payment of $1.6 million over the term of the associated contract volumes.

The following table presents the Company's oil and natural gas sales disaggregated by revenue source:

	Three months ended March 31,	
	2021	2020
Oil and natural gas revenue		
Natural gas(1)(2)	**6,022**	5,322
Oil	**4,032**	3,018
NGL	**1,482**	2,157
Total oil and natural gas revenue	**11,536**	10,497

(1) Includes revenue related to the market diversification contract of $2.2 million for the three months ended March 31, 2021 (Q1 2020 – nil). Also included are losses of $0.8 million related to physical forward sales contracts which settled during the period (Q1 2020 – losses of $1.6 million).

(2) For the three months ended March 31, 2021, natural gas revenue includes $1.1 million (Q1 2020 – nil) of non-cash revenue taken in-kind related to production used in the settlement of the retained East Edson royalty obligation (note 11).

Included in accounts receivable at March 31, 2021 is $3.2 million of accrued oil and natural gas revenue related to March 2021 production (December 31, 2020 – $2.3 million related to December 2020 production).

17. FINANCE EXPENSE

The components of finance expense are as follows:

	Three months ended March 31, **2021**	2020
Cash finance expense		
Interest on revolving bank debt	**276**	879
Interest on term loan	**–**	911
Interest on 2022 Senior Notes[(1)]	**(1,253)**	735
Interest on lease liabilities (note 12)	**40**	45
Total cash finance expense	**(937)**	2,570
Non-cash finance expense		
Interest paid in-kind on term loan (note 9)	**948**	–
Interest paid in-kind on 2025 Senior Notes (note 10) [(1)]	**2,057**	–
Gain on senior note maturity extension (note 10)	**(1,591)**	–
Amortization of debt issue costs	**378**	347
Accretion on decommissioning obligations (note 13)	**98**	166
Change in fair value of royalty obligations (note 11)	**1,109**	52
Total non-cash finance expense	**2,999**	565
Finance expenses recognized in net loss	**2,062**	3,135

(1) On January 22, 2021, Perpetual's 2022 Senior Notes were exchanged for 2025 Senior Notes, providing Perpetual the option to pay interest in-kind. Perpetual elected to pay the January 23, 2021 semi-annual interest of $1.5 million by a PIK Interest Payment. As a result, the previously accrued 2022 Senior Note cash interest of $1.3 million was reversed and replaced by $1.3 million of 2025 Senior Note non-cash interest expense. The Company intends to satisfy the semi-annual interest payment due July 23, 2021 by making a PIK Interest Payment and has accrued $0.8 million of non-cash interest expense for the three months ended March 31, 2021.

18. FINANCIAL RISK MANAGEMENT

Natural gas contracts

At March 31, 2021 the Company had entered into the following physical fixed price natural gas sales arrangements at AECO:

Term	Sold/bought	Volumes (*GJ/d*)	Average price (*$/GJ*)	Fair Value (*$ thousands*)
April 2021	Bought	2,500	2.36	13
April 2021	Sold	15,000	2.70	74

In addition, at March 31, 2021, the Company had entered into various fixed price basis differential contracts between AECO and NYMEX for terms settling in 2021 that have been substantially locked-in by similar equal and offsetting arrangements having an aggregate fair value loss of $2.5 million.

Natural gas contracts - sensitivity analysis

As March 31, 2021, if future natural gas prices changed by $0.25 per GJ with all other variables held constant, the fair value of derivatives and net loss for the period would change by $0.1 million. Fair value sensitivity was based on published forward AECO and NYMEX prices.

Oil contracts

At March 31, 2021, the Company had entered into the following physical fixed price oil sales arrangements which settle in US$:

Term	Volumes (*bbls/d*)	Western Canadian Select ("WCS") (US*$/bbl*)	Fair Value (*$ thousands*)
April 2021 – June 2021	207	42.00	(170)
May 2021 – June 2021	155	51.70	38

Term	Volumes (*bbls/d*)	WTI-WCS differential (*US$/bbl*)	Fair Value (*$ thousands*)
April 2021 – September 2021	203	(14.20)	(154)
April 2021 – December 2021	310	(13.25)	(205)

Oil contracts - sensitivity analysis

As at March 31, 2021, if future WTI oil prices changed by US$5.00 per bbl with all other variables held constant, the fair value of derivatives and net loss for the period would change by $0.2 million.

As at March 31, 2021, if future WTI-WCS differential oil prices changed by US$5.00 per bbl with all other variables held constant, the fair value of derivatives and net loss for the period would change by $0.8 million.

The following table summarizes the fair value of derivative contracts by type:

	March 31, 2021	December 31, 2020
Physical natural gas contracts	**$ (2,446)**	$ (3,351)
Physical oil contracts	**(491)**	(22)
Fair value of derivatives	**$ (2,937)**	$ (3,373)
Derivative liabilities – current	**(2,937)**	(3,373)
Derivative liabilities – non-current	**–**	–
Fair value of derivatives	**$ (2,937)**	$ (3,373)

The following table details the change in fair value of derivatives:

	Three months ended March 31,	
	2021	2020
Unrealized gain (loss) on physical natural gas contracts	**905**	(279)
Unrealized gain (loss) on financial natural gas contracts	**–**	107
Unrealized gain (loss) on physical oil contracts	**(469)**	–
Unrealized gain (loss) on financial oil contracts	**–**	11,808
Unrealized gain (loss) on financial NGL contracts	**–**	467
Unrealized gain (loss) on financial foreign exchange contracts	**–**	40
Unrealized change in fair value of derivatives	**436**	12,143
Realized gain (loss) on financial natural gas contracts(1)	**(1,374)**	(1,805)
Realized gain (loss) on financial oil contracts	**–**	1,286
Realized gain (loss) on financial NGL contracts	**–**	(143)
Realized gain (loss) on financial foreign exchange contracts	**–**	(388)
Change in fair value of derivatives	**(938)**	11,093

(1) Includes realized losses of $1.4 million from the elimination of the Company's market diversification contract obligations for the April 1, 2021 to October 31, 2021 period. There were no modifications to the market diversification contract in the first quarter of 2020.

Fair value of financial assets and liabilities

The Company's fair value measurements are classified into one of the following levels of the fair value hierarchy:

Level 1 – inputs represent unadjusted quoted prices in active markets for identical assets and liabilities. An active market is characterized by a high volume of transactions that provides pricing information on an ongoing basis.

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These valuations are based on inputs that can be observed or corroborated in the marketplace, such as market interest rates or forecasted commodity prices.

Level 3 – inputs for the asset or liability are not based on observable market data.

The Company aims to maximize the use of observable inputs when preparing calculations of fair value. Classification of each measurement into the fair value hierarchy is based on the lowest level of input that is significant to the fair value calculation.

The fair value of cash and cash equivalents, accounts receivable, prepaid expenses and deposits, and accounts payable and accrued liabilities approximate their carrying amounts due to their short terms to maturity. The Credit Facility bears interest at a floating market rate, and accordingly, the fair market value approximates the carrying amount.

The fair value of the royalty obligations is estimated by discounting future cash payments based on the forecasted natural gas and NGL commodity prices multiplied by the royalty volumes. This fair value measurement is classified as level 3 as significant unobservable inputs, including the discount rate and forecasted natural gas and NGL commodity prices, are used in determination of the carrying amount. Discount rates of 12.0% to 12.2% were determined on inception of the agreements based on the characteristics of the instruments.

The fair value of financial assets and liabilities, excluding working capital, is attributable to the following fair value hierarchy levels:

As at March 31, 2021	Gross	Netting[1]	Carrying Amount	Fair value Level 1	Fair value Level 2	Fair value Level 3
Financial assets						
Fair value through profit and loss						
Fair value of derivatives	8,551	(8,551)	–	–	–	–
Financial liabilities						
Financial liabilities at amortized cost						
Revolving bank debt	(17,224)	–	(17,224)	(17,224)	–	–
Senior notes	(32,794)	–	(32,794)	–	–	(35,637)
Term loan	(47,771)	–	(47,771)	–	–	(47,771)
Fair value through profit and loss						
Fair value of derivatives	(11,488)	8,551	(2,937)	–	(2,937)	–
Royalty obligations	(5,889)	–	(5,889)	–	–	(5,889)

(1) Derivative assets and liabilities presented in the condensed interim consolidated statements of financial position are shown net of offsetting assets or liabilities where the arrangement provides for the legal right, and intention for net settlement exists.