

January 14, 1999

Mineral Rights Information Bulletin 99-2

SUBJECT: PETROLEUM AND NATURAL GAS TENURE REVIEW

In September 1995, the Minerals Tenure Branch of the Alberta Department of Energy reviewed its petroleum and natural gas tenure policies and regulations. The Petroleum and Natural Gas Tenure Review Advisory Committee was established, with representatives from the Ministry of Energy and industry associations.

The review resulted in the *Mines and Minerals Amendment Act 1997*, the Petroleum and Natural Gas Tenure Regulation, the Mines and Minerals Administration Regulation and the Crown Minerals Registration Regulation, being proclaimed effective January 1, 1998.

The Department of Energy is committed to meeting the evolving business needs of its clients. As a result of this commitment, the Advisory Committee met in June 1998 to consider additional changes to petroleum and natural gas tenure, including changes to regulations and business rules.

The attachment, *Proposal for Refining Business Rules for Petroleum and Natural Gas Tenure in Alberta 1999*, is being released for review and feedback.

We invite your comments to be made directly to:

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All comments should be received by February 15, 1999. The names of the contributors will be kept confidential, but all comments will be shared with the industry associations represented on the Industry Advisory Committee.

(over)

If you require further explanation or information, please call Paul Batke at (403) 422-9389* or me at (403) 422-9430*.

F. David Coombs
Executive Director
Minerals Tenure Branch

Attachment

***Please Note:** *Effective January 25, 1999, the area code changes from '403' to '780'.*

PROPOSAL

FOR

REFINING

BUSINESS RULES

FOR

PETROLEUM AND NATURAL GAS

TENURE

IN

ALBERTA

1999

Prepared by
Minerals Tenure Branch
Mineral Operations Division
Alberta Department of Energy

PROPOSAL FOR REFINING BUSINESS RULES FOR PETROLEUM AND NATURAL GAS TENURE IN ALBERTA 1999

1. BACKGROUND

In September 1995, the Minerals Tenure Branch initiated discussions with industry in order to review its petroleum and natural gas tenure policies and regulations. The Petroleum and Natural Gas Tenure Review Advisory Committee was established, with representation from the Ministry of Energy and five industry associations: the Canadian Association of Petroleum Producers, the Small Explorers and Producers Association of Canada, the Canadian Association of Petroleum Landmen, the Canadian Association of Petroleum Land Administration and the Petroleum Joint Venture Association.

Since that time, a total of 11 meetings were held by this Advisory Committee, resulting in the publication of 10 proposals for industry review. The review resulted in *the Mines and Minerals Amendment Act 1997*, the Petroleum and Natural Gas Tenure Regulation, the Mines and Minerals Administration Regulation and the Crown Minerals Registration Regulation. The amendments to the Mines and Minerals Act as it pertained to petroleum and natural gas tenure and the three associated regulations took effect on January 1, 1998.

The Department is committed to introducing further changes where necessary. In consultation with the Advisory Committee, the Department is recommending the changes identified in this proposal and invites industry's comments and suggestions.

2. DEPARTMENT OF ENERGY MISSION

Ensure Alberta's energy and mineral resources are developed and used in an effective, orderly and environmentally responsible manner in the interests of Albertans.

3. MINERAL OPERATIONS DIVISION MISSION

Generate wealth for Albertans by responsible and effective management of energy and mineral resources through tenure, tax and royalty.

4. PETROLEUM AND NATURAL GAS TENURE PHILOSOPHIES

To guide petroleum and natural gas development in Alberta, the Department of Energy has adopted a number of philosophies:

- 4.1 Ensure that industry has the opportunity to receive an appropriate reward and recognition for risks taken.
- 4.2 Ensure that government optimizes its share of economic rent over time in bonuses, rent and royalty.

- 4.3 Establish and maintain an open, two-way dialogue on existing processes and proposed alternatives.

These philosophies may be accomplished by:

- minimizing the administrative burden for both industry and government;
- having clear, consistent and concise rules;
- avoiding having industry drill unnecessary wells;
- aligning definitions and practices between government agencies;
- returning non-productive rights as quickly as possible.

5. PETROLEUM AND NATURAL GAS LICENCE ADMINISTRATION

5.1 GROUPINGS

BACKGROUND:

Under the present system:

- (1) a grouping is granted upon application when the two initial-term licences are within 3.2 km of each other and the grouping well is to be drilled on one of the licences in order to evaluate petroleum and natural gas rights in the locations of both licences.
- (2) grouping is not available for more than two licences, or for licences that are more than 3.2 km apart.
- (3) application for grouping must be received in the Department before the grouping well is spudded.
- (4) a particular licence may be in only one group at any one time.

When the grouping provision for petroleum and natural gas licences was first introduced in July 1976, a maximum of two licences for each group was deemed appropriate to support an oil or gas play. Since that time, the average size of licences has been decreasing gradually (average size in fiscal 1978/79 was 9.8 sections; in fiscal 1997/98, it was 5.3 sections, a decrease of 47%). Therefore, the Department feels that the current maximum limitation of two licences per group is no longer reasonable to support a larger oil or gas play.

The intent of the new grouping provision is to pattern licence groupings after the current Section 16 in the Petroleum and Natural Gas Tenure Regulation, i.e. more than one agreement may be evaluated by the drilling of one grouping well.

The proposal which follows is intended to provide greater flexibility to industry with respect to grouping licences as well as reducing the administrative burden for both industry and the Department.

PROPOSAL:

- (1) A licence group may consist of more than two licences. The application for licences to be grouped may be made before, during or after the drilling of the grouping well, provided that:
 - The distance between the licences to be grouped with the licence on which the grouping well is located is 1.6 km or less. A licence where the diagonally cornering distance between it and the licence on which the grouping well is located is 2.26 km would also qualify for grouping. This will permit any number of licences to be grouped provided that these licences meet the above distance criteria (refer to Attachment 1). The group may also include any number of vertically stacked licences (refer to Attachment 2).
 - The application is made while all licences are still in their initial term.
 - The well is spudded while all licences are still in their initial term.
 - The grouping well must evaluate petroleum and natural gas rights in the locations of all licences.
 - The sections that are earned, based on the total measured depth, must be assigned to each licence in the group at the time of application.
- (2) Once the grouping entitlement for all licences has been assigned by the Department, no changes will be permitted.

5.2 TABLE WITHIN SCHEDULE 2 OF THE P&NG TENURE REGULATION

BACKGROUND:

Under the present system:

- (1) within the Plains Region, there is no provision to grant entitlement for any well drilled shallower than 150 m. The Department has been made aware of several situations where natural gas was discovered at a depth considerably shallower than 150 m.
- (2) within the Foothills Region, a well drilled to 150 m will earn 8 sections entitlement for a licence. This is perceived to be overly generous, especially since the likelihood of finding natural gas at this depth is rare.

PROPOSAL:

- (1) for the Plains Region, permit any well drilled up to 150 m which is considered productive by the Minister to earn 3 sections of entitlement.
- (2) for the Foothills Region, a well must be drilled to 300 m before any entitlement is earned. Permit any well drilled up to 300 m to earn 8 sections of entitlement provided that the well is considered to be productive by the Minister.

6. CONTINUATIONS

6.1 SECTION 16

BACKGROUND:

Section 16(3)(b) provides for continuation, upon application, but without the submission or assessment of technical data, for one lease to a maximum of five sections. If the lease contains more than five sections, the lessee may select the five sections which he wishes to continue.

While this change has achieved the desired effect of reducing administration for both industry and the Department, there is currently no provision which accommodates the continuation of a number of smaller leases within the vicinity of a Section 16 qualifying well.

PROPOSAL:

Allow continuation pursuant to Section 16 for up to five sections, for any number of leases, without the submission or assessment of technical data provided that the leases containing the five sections to be continued touch or corner the lease containing the Section 16 qualifying well. All leases must be held by the same lessee who is applying for the Section 16 continuation or the appropriate letters of authorization would still be required by the Department.

Industry is reminded, however, that it will still not be possible to both pick five sections and map more sections for continuation under Section 16 by using the same qualifying well. It should be noted that a lessee may still pursue the technical option by applying for more than five sections and fall back to five sections under Section 16(3)(d) if the original application is denied.

6.2 SECTION 16 OFF-LOCATION WELLS

BACKGROUND:

Under the current system, an off-location well may be used to continue a lease pursuant to Section 16 provided that technical data is submitted to substantiate that the drilling of the Section 16 off-location well evaluates the rights in the expiring lease. Presently, no evidence of involvement in the off-location well is required. This appears to be contrary to the risk/reward principle (See Section 4.1 of this Proposal).

PROPOSAL:

If the applicant is not also the well licensee for the off-location well, the Department will require a letter of authorization from the designated representative of the lease or licence that the off-location well is to be drilled on.

6.3 SECTION 15 CONTINUATIONS BASED ON EUB APPROVED PROJECTS

BACKGROUND:

The Department used to treat leases within EUB approved projects much like leases within unit agreements, i.e. these leases automatically qualified for indefinite continuation under Section 15. Recently, the Department has been made aware of situations where wells with no accompanying reserves assigned are included in Projects. This is coupled with the EUB's practice of recognizing, for statistical purposes, the Project status assigned to wells even though they are no longer producing. Automatic continuation could therefore result in the unnecessary perpetuity of non-productive petroleum and/or natural gas rights. This illustrates the deficiency in automatically continuing leases within Projects.

CHANGE IN DEPARTMENTAL POLICY:

Require lessees to provide evidence of productivity as required by Section 15 even though the lease may be included within an EUB approved project.

7. OFFSETS

7.1 SERVING OF OFFSET NOTICES WITHIN EUB APPROVED PROJECTS

BACKGROUND:

The Department also used to consider EUB approved projects much like unit agreements for purposes of offset administration and, therefore, did not serve offset notices to Crown lessees within projects. Recently, the Department has been made aware of situations where project status is still assigned to wells even though they are no longer producing.

CHANGE IN DEPARTMENTAL POLICY:

Serve Crown lessees offset notices even though the lease(s) are included within an EUB approved project and require lessees to provide evidence of productivity by utilizing the review procedure as outlined in Section 21 of the Petroleum and Natural Gas Tenure Regulation.

7.2 SERVING NOTICES ON DIAGONALLY CORNERING SPACING UNITS

BACKGROUND:

Currently, an offset obligation arises for laterally adjoining Crown spacing units to a producing freehold well's spacing unit. This system does not prevent the drainage of Crown spacing units which corner the spacing units for a producing freehold well.

PROPOSAL:

Amend the Petroleum and Natural Gas Tenure Regulation to include Crown spacing units which diagonally corner the spacing units for a producing freehold well.

8. OFFSET COMPENSATION

BACKGROUND:

Section 22(5) of the Petroleum and Natural Gas Tenure Regulation outlines the various means by which the liability of a lessee to pay offset compensation ends. As currently worded, the onus is placed on the Department to identify the various scenarios. Since this portion of the Department's business is not currently automated, this is a very time-consuming manual task.

PROPOSAL:

The liability of a lessee to pay offset compensation shall end as of the first day of the month in which an application is received in the Department which meets the criteria of Section 22(5). The onus will rest with the Crown lessee to apply in a timely manner to end the payment of offset compensation.

9. APPLICATIONS WHERE MINISTER DISAGREES

BACKGROUND:

Section 14 of the Petroleum and Natural Gas Tenure Regulation sets out the action required by the Minister where the Minister disagrees in whole or in part with an application for continuation. There is no equivalent clause for petroleum and natural gas licence or offset administration.

PROPOSAL:

Include a similar provision to encompass other applications required pursuant to the Petroleum and Natural Gas Tenure Regulation (such as petroleum and natural gas licence administration and offset administration).

10. TRESPASS

BACKGROUND:

Under Sections 53 and 53.1 of the Mines and Minerals Act, the Minister may direct that compensation be paid for trespass on Crown rights. Section 53.1 of the Act currently allows certain costs to be deducted from the value of a mineral produced in trespass. Unfortunately, allowing these deductions has the effect of minimizing the severity of the trespass offence in that the offending party winds up paying little, if any, compensation to the Crown.

Another form of trespass occurs when a company drills into and tests or conducts operations with respect to a zone(s) which is undisposed Crown. In this scenario, the Crown does not currently receive any monetary consideration, which unjustifiably decreases the seriousness of this type of trespass.

PROPOSAL:

- (1) Eliminate the deduction for reasonable direct costs incurred by the trespasser. Thus, all the production accrued from Crown undisposed petroleum and natural gas rights during the time of the trespass would belong to the Crown.
- (2) Establish a trespass penalty of \$40,000.00 for each instance for which the Crown establishes that trespass has occurred. It should be noted that no trespass fee will be charged in those situations involving misdescribed zones. An unpaid trespass penalty will constitute a debt to the Crown.
- (3) All well information obtained through the trespass of Crown rights must be made available immediately by the EUB.

11. WATER INJECTION, WATER DISPOSAL, WATER SOURCE AND OBSERVATION WELLS

BACKGROUND:

The administration relating to these types of wells is becoming more problematic for the Department as well as for industry. Since these particular wells do not require a petroleum and natural gas agreement in order to inject, dispose or observe, a company wishing to explore and develop their own rights may not always be aware of these wells, particularly when the EUB has recently granted approval.

Option A: Issue Zone-Specific Leases

On a go-forward basis, the Department would issue a zone-specific lease for any water injection, water disposal, water source or observation well that is not included within an active petroleum and natural gas lease or licence. The Department contemplates incorporating the following features:

- a special agreement (to distinguish it from the petroleum and natural gas types) which authorizes the lessee to use a particular zone for injection, disposal, water source or observation purposes.
- administrative fee to issue will be \$500.
- rent will be charged at \$3.50 per hectare.
- minimum size will be a quarter section.
- lease will have an indeterminate term, however, the Department will need the ability to terminate the lease upon abandonment of the injection, disposal, water source or observation well.

Option B: Charge for Approval to Conduct Operations into Undisposed Crown

Continue the current process of requiring the applicant to get approval prior to drilling these types of wells into undisposed Crown. In addition, an administrative fee of \$500 would be applied against each particular well's approval. Wells receiving the Department's approval would be flagged in our mainframe computer system LSAS by placing a remark against each well. A company drilling such a well without prior approval by the Department would be required to pay the trespass penalty of \$40,000 outlined in Section 10 of this Proposal.

Note: Any hydrocarbons encountered during these operations will require the immediate release of all well information and the posting of undisposed Crown rights by public sale.

12. DESIGNATED REPRESENTATIVE

BACKGROUND:

Section 24(5) of the Mines and Minerals Act indicates that no agreement shall be issued (by transfer or sale) to an unincorporated syndicate or association. There is no corresponding restriction as to the designated representative or the official service address. This has caused considerable confusion and extra administration for the Department.

PROPOSAL:

Amend the legislation to require that designated representatives be registered under the same legislation as lessees and as set out in Section 24(2) of the Mines and Minerals Act.

13. OFFICIAL SERVICE ADDRESS

BACKGROUND:

Section 3(1) of the Mines and Minerals Administration Regulation states that a person shall not have more than one official service address and that notice of that address shall be in the form determined by the Minister.

PROPOSAL:

Within the next year, the Department will contact clients with multiple service addresses and ask that this client confirm his official service address in writing.

14. FORMS AND GUIDES

BACKGROUND:

Forms for use in association with statutory requirements, i.e. the registration of transfers and encumbrances, are no longer included in a regulation. Information Letter 97-34 prescribed most of the forms to be used after January 1, 1998. Some of these forms require minor amendments. The Department has also been asked to prescribe forms for applications of petroleum and natural gas rights by direct purchase and a form to be used to satisfy offset obligations.

PROPOSAL:

The Department is currently reviewing all of the forms currently in use and will prescribe amended or new forms and guides by information letter. The Department will work closely with the Canadian Association of Petroleum Land Administration to make the necessary changes, however, any individual comments you may have are certainly most appreciated.