

March 28, 2001

SUBJECT: PETROLEUM AND NATURAL GAS REVIEW

The Department of Energy (formerly Department of Resource Development) is committed to meeting the evolving tenure needs of its clients. In December 2000 and in February 2001 the Industry Advisory Committee on Petroleum and Natural Gas Tenure met to consider some changes to the petroleum and natural gas tenure rules, including changes to regulations and policy.

The attachment, *Refining Business Rules for Petroleum and Natural Gas Tenure in Alberta 2001*, is being released for review and feedback.

Please provide any comments to:

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All comments should be received in the Department by Thursday, April 12, 2001. While the names of the contributors will be kept confidential, all comments will be shared with the industry associations represented on the Industry Advisory Committee.

If you require further explanation or information, please call Paul Batke at (780) 422-9389 or me at (780) 422-9430.

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[Attachment](#)
[Appendix 1](#)
[Appendix 2](#)

REFINING BUSINESS RULES FOR PETROLEUM AND NATURAL GAS

TENURE IN ALBERTA 2001

1. Petroleum and Natural Gas Tenure Philosophies, Objectives and Principles

In September 1995, the Alberta Department of Energy commenced a joint review of Alberta's petroleum and natural gas tenure regime with representatives of various industry associations, including the Canadian Association of Petroleum Producers (CAPP), the Small Explorers and Producers Association of Canada (SEPAC), the Canadian Association of Petroleum Landmen (CAPL), and the Canadian Association of Petroleum Land Administration (CAPLA).

The following philosophy, objectives, and principles were jointly agreed to, communicated to industry and continue to govern the tenure review today:

Philosophy

"Ensure that petroleum and natural gas rights are managed as effectively and efficiently as possible, and in a fashion that optimizes the economic benefit to Albertans."

Objectives

- "Ensure that industry receives an appropriate reward and recognition for risks taken."
- "Ensure government optimization of economic rent (i.e., bonuses, fees, rentals, royalties)."
- "Establish and maintain an open two-way dialogue on existing processes and proposed alternatives."

Principles

- "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."

As a result of consultation with the Industry Advisory Committee on Petroleum and Natural Gas Tenure the following items were identified as needing broader industry discussion.

2. Offset Administration

The purpose of serving offsets on Crown spacing units adjacent to freehold spacing units containing producing freehold wells is to protect the Crown's interest. In the past, various changes have been introduced to the offset provisions to ensure that this, in fact, is being accomplished. There remain several issues, however, which either appear to be at odds with the stated goal of protecting the Crown's interest or create barriers for industry.

2.1 Offset Notice Period

Background

Effective January 1, 1998, the offset provisions were amended to require that industry not only drill to the offset zone but also to require that the well be producing from the offset zone, all within the 3-month notice

period. This has proven to be onerous at times, especially where deep wells were required to satisfy the offset notice.

Proposal

Amend the notice period for offsets from 3 months to 6 months. This will permit industry to meet the goal of drilling to and producing from the offset zone within the allotted notice period.

This change requires an amendment to the *Petroleum and Natural Gas Tenure Regulation*.

2.2 Offset Compensation in Year One

Background

The Crown currently permits the election to pay offset compensation as a means to defer the obligation to produce on the adjoining Crown offsetting spacing unit. At present, the rate of offset compensation charged is 50 % for the first year. The rate was presumably set at this amount in order to encourage drilling. To the best of our knowledge, this rate has had little, if any effect on stimulating early drilling and production to satisfy the offset obligation.

A recent review of industry companies who own fee simple mineral rights confirmed that most companies provide the option of paying offset compensation to defer the offset obligation. All who charge offset compensation begin collecting at 100 % in the first year.

Proposal

In the interest of stimulating drilling and production to satisfy Crown offset obligations, offset compensation will be charged at a rate of 100% in the first and subsequent years. This will also offset the change to six months for the offset notice period.

This change requires an amendment to the *Petroleum and Natural Gas Tenure Regulation*.

3. Petroleum and Natural Gas Licences

There have been some significant changes made to the tenure of petroleum and natural gas licences since January 1998. Those changes were included in the first phase of the Petroleum and Natural Gas Tenure Review that began in 1995. There are a few minor problems that remain to be resolved.

3.1 Use of Re-entry Wells as Grouping Wells

Background

When petroleum and natural gas licences were first introduced as a tenure agreement effective July 1, 1976, there was an inherent obligation to conduct the drilling of a new well in order to earn validation. Effective January 1, 1998 an amendment was introduced which recognized that re-entry wells could be a viable alternative to the drilling of a new well. As a result, re-entry wells could validate a single licence, however, the concept was not intended to extend to licence groupings.

The Department recognizes that re-entry wells provide new evaluation, in some instances at considerable cost, while minimizing surface disturbance.

POLICY CHANGE

As the Department's legal counsel have advised that the *Petroleum and Natural Gas Tenure Regulation* does not prohibit the use of re-entry wells as grouping wells, the Department is implementing this new policy effective immediately:

Permit re-entry wells to be used as grouping wells as follows:

- A well that is re-entered for the purpose of evaluating petroleum and natural gas rights in the locations of all grouped licences during the initial term of all licences and the well is either
 - a. drilled to at least the minimum depth beyond the total measured depth of the well prior to the re-entry, or
 - b. whipstocked from a point in the well-bore and drilled beyond that point to at least the minimum depth
"minimum depth" is defined as
 - (i) 150 metres of measured depth in the Plains Region or the Northern Region and 300 metres of measured depth in the Foothills Region, or
 - (ii) a lesser depth approved by the Minister in any particular case;

3.2. Other Validating Wells as Grouping Wells

POLICY CHANGE

If a spacing unit is located partly within and partly outside a licence, a well drilled on the outside portion may be considered a grouping well. No part of the spacing unit may be within any other licence that is still in its initial term, and the well must meet the usual conditions of being drilled during the initial term of the licence to a depth of at least the minimum depth and evaluating the rights contained in the licence.

3.3. Off-Location Wells

Background

When licences were introduced in July 1976, a well was required to be drilled in the location of the licence to qualify for validation entitlement. The Department continues to believe that the best location to evaluate the licence is on the location of the licence. However, a provision was included to accommodate off-location wells in rare instances, primarily where the terrain was such that the drilling of an on-location well would cause serious damage to the environment.

The Department will continue to accept applications for off-location wells in those instances where the licensee is able to provide evidence that a well drilled on the location of the licence would cause significant environmental damage or where there is no suitable surface location on the licence.

Proposal

Consider allowing an off-location well provided that all the following criteria are met:

- The well must be drilled on a Crown petroleum and natural gas agreement.
- Crown agreement containing the off-location well may not expire within one year of the receipt of application for the off-location well. For example, a lease may not be in the fifth year of its primary term, or an intermediate term licence cannot be in its fifth year when the application for approval of the off-location well is received in the Department.

- Section containing the off-location well and the petroleum and natural gas licence cannot be separated by more than one intervening section at their closest points.
- Technical data is presented to the Crown to show that the off-location well does in fact evaluate the licence.

This change requires an amendment to the *Petroleum and Natural Gas Tenure Regulation*.

3.4. Simplification of Table in Schedule 2

Background

The calculation of licence entitlement is complicated by the need to multiply metres drilled by an Incremental Factor. In the past, some companies have miscalculated their entitlement because of a simple math error or not understanding the use of the Incremental Factor. It is also administratively burdensome and awkward.

Proposal

Eliminate the use of an Incremental Factor in the Table so that the Table provides for a finite number of complete sections based on Total Measured Depths drilled (refer to Appendices 1 and 2).

This change will require an amendment to the *Petroleum and Natural Gas Tenure Regulation*.

4. Trespass

Background

The Department views the issue of trespass as serious. Trespass can provide a company with an opportunity to have an unfair advantage by acquiring information to which it is not entitled. Trespass may also compromise the integrity of the sales process.

At one time, the incidence of trespass against Crown petroleum and natural gas rights was a rare occurrence. In recent years, however, the number of incidents has been steadily increasing.

Although there is a provision in the Mines and Minerals Act dealing with trespass, (Section 59 provides for the imposition of a maximum \$100,000 penalty), the Crown would need to prove deliberate intent on the part of the trespasser. As a result, this provision is ineffectual in curbing what the Crown considers to be a serious matter.

Presently, the Department retains all of the production obtained as a result of the trespass against the Crown, however, the following costs are normally allowed to be deducted:

- operating or "lifting" costs
- transportation
- capital expenditure

It is very time-consuming for both the Department and industry to determine costs incurred. As a result, after a lengthy process, there is often no money collected by the Department. This lack of penalty has not been a strong enough deterrent.

The Department will continue to withdraw or defer sales parcels whenever information appears to have been obtained as a result of potential trespass.

The following options are being considered:

Proposal

Option 1

This option comes out of the June 14, 1999 Industry Round Table Discussion. The Department subsequently released its intentions in Mineral Rights Information Bulletin 99-5 dated August 25, 1999:

- the need for an escalating penalty, starting with \$20,000 for the first offence and escalating in \$20,000 increments for subsequent offences
- capping the penalty at a maximum of \$100,000
- eliminating the deduction for any costs incurred by the trespasser other than royalty that has already been paid
- requiring immediate release by the Alberta Energy and Utilities Board (EUB)

of all well information obtained through the trespass of Crown rights

The Department is also considering reducing the maximum penalty of \$100,000 to \$20,000 after the company in question has been performing without a trespass for a number of years (five?). The process would then re-start with the penalty at \$20,000, moving up the ladder with each subsequent trespass.

Option 2

This option would see a standardized trespass penalty of \$50,000 applied for each instance of trespass. As with Option 1, the Department would eliminate the deduction for any costs incurred by the trespasser other than royalty that may have already been paid. In addition, the Department will request that any information acquired in trespass be immediately provided to the EUB along with a letter authorizing the EUB to immediately release all well information obtained through the trespass of Crown rights.

- NOTE:**
1. **For either option, the Department proposes to levy the trespass penalty as an administrative penalty.**
 2. **For either option, the Department proposes to levy the penalty against the well licensee as in many instances there is no Crown agreement against which the penalty may be applied.**
 3. **The Minister may waive the penalty pursuant to the provisions of the *Mines and Minerals Act*.**

5. New Format for Describing Petroleum and Natural Gas Rights

The Department is replacing its current automated system for disposition of petroleum and natural gas rights with a new system. We have determined that there are several different formats used to describe rights. For example, the following is currently used to describe what amounts to essentially the same petroleum and natural gas rights:

- Petroleum and natural gas.
- Petroleum and natural gas from surface to basement.
- Petroleum and natural gas in all zones.

The Department proposes to consistently describe all the available rights by using the terminology "petroleum and natural gas in all zones". This implies that a company will own all rights from surface to the base of the deepest stratum in the location (including the Precambrian). This means that the Department will

no longer consider any applications for rights below the top of the Precambrian zone where there is an existing agreement that relates to "petroleum and natural gas in all zones".

The Department will introduce this change as soon as the Department's computers can be changed. It does not require an amendment to existing legislation.

**Current
Earning Entitlement (sections)
For Validating and Grouping Wells
Drilled on P & NG Licences**

	Plains	Northern	Foothills
Well Depth (metres)			
Min. Depth (150m)	3	5	8
600	3	6	9
752	4	7	10
900	4	7	10
1052	5	8	11
1200	5	8	11
1352	6	9	12
1500	6	9	12
1652	7	10	13
1800	7	10	13
1952	8	11	14
2100	8	11	14
2201	9	12	15
2400	9.5	12.5	16
2501	10.5	13.5	16
2700	11	14	18
2756	12	14	18
2776	12	15	19
2928	13	16	20
3000	13	16	20
3076	14	17	21
3228	15	18	22
3300	15	18	22
3376	15	19	23
3528	15	20	24
3600	15	20	24

3676	15	21	25
3828	15	22	26
3900	15	22	26
3976	15	23	27
4128	15	24	28
4200	15	24	28
4276	15	25	29
4428	15	26	30
4500	15	27	31
4551	15	28	32
4651	15	29	33
4800	15	30	34
4851	15	31	35
5000	15	32	36

Proposed
Earning Entitlement (sections)
For Validating and Grouping Wells
Drilled on P & NG Licences

	Plains	Northern	Foothills
Well Depth (metres)			
Min. Depth (150m)	3	5	8
600	3	6	9
750	4	7	10
900	4	7	10
1050	5	8	11
1200	5	8	11
1350	6	9	12
1500	6	9	12
1650	7	10	13
1800	7	10	13
1950	8	11	14
2100	8	11	14
2200	9	12	15
2300	9	13	15
2400	10	13	16
2500	10	14	16
2700	11	14	18
2750	12	14	18
2775	12	15	19
2925	13	16	20
3000	13	16	20
3075	14	17	21
3225	15	18	22
3300	15	18	22
3375	15	19	23
3525	15	20	24
3600	15	20	24
3675	15	21	25

3825	15	22	26
3900	15	22	26
3975	15	23	27
4125	15	24	28
4200	15	24	28
4275	15	25	29
4425	15	26	30
4500	15	27	31
4550	15	28	32
4650	15	29	33
4800	15	30	34
4850	15	31	35
5000	15	32	36