

September 30, 1996

Subject: Petroleum and Natural Gas Tenure Review

This Bulletin is a follow-up to Information Bulletin 96-3, which introduced proposals for redesigning agreement types in Alberta.

We thank those of you who took the time to send us your comments on the proposal. We have now amended it to address your concerns and to reflect our discussions with CAPP, CAPL, CAPLA and SEPAC.

This document is being used as the basis for drafting changes to the Mines and Minerals Act and the P & NG Agreements Regulation. The proposed changes to the Act were circulated in September for your review and input, and the suggested amendments to the Regulation will be circulated at the beginning of next year.

If you require further explanation or information, please call Julie Miles at 422-9374, Paul Batke at 422-9389 or me at 422-9430.

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PROPOSAL FOR REDESIGNING AGREEMENT TYPES IN ALBERTA

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Petroleum and Natural Gas Tenure Review

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A PROPOSAL FOR REDESIGNING AGREEMENT TYPES IN ALBERTA

1. 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.

2. Mineral Operations Division Mission

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

3. Philosophy of Petroleum and Natural Gas Tenure Review

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.

4. Philosophy of Rights Management Review

- Ensure that industry receives an appropriate reward and recognition for risks taken.
- Ensure government optimization of economic rent (ie: bonuses, fees, rentals, royalties).
- 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. Proposal to redesign P & NG Licence Administration

5.1 Groupings Background:

Under the present system:

(1) a grouping is granted upon application when the licences are within 3.2 km of each other, and when the well is drilled on one licence and is located no more than 3.2 km away from the other; (2) a well that is more than 3.2 km away from the undrilled licence will not be accepted as a grouping well unless the licensee first demonstrates that it will evaluate rights in both licences; (3) grouping is not available for more than two licences, or for licences that are more than 3.2 km apart; (4) the approval must be granted before the well is spudded.

Proposal:

(1) Maintain the ability to group two licences for lease-earning purposes where the licences are located no more than 3.2 km apart. (2) Two licences that are no more than 3.2 km apart may be grouped upon application, without technical data, regardless of the location of the grouping well on the grouped licences. (3) Grouping will continue to be unavailable for more than two licences, or for licences that are more than 3.2 km apart. (4) The application for the grouping well must be made before the drilling of the well, and both licences must be active at the time the well is spudded. The well location, once approved, may be moved elsewhere provided that it remains on the location of one of the licences. Moving it off the grouped licences will invalidate the grouping approval.

5.2 Rental Waivers

Background:

In fiscal 1994-95, there were 6,100 licences in existence, of which 373, or 6%, received rental waivers amounting to \$1,729,455. Of the 109 companies who benefited from this program, 73% received less than \$15,000, and only 6% received more than \$50,000.

The corresponding figures for fiscal 1995-96 show that 1,050 of 5203 licences, or 20%, received rental waivers amounting to \$4,756,329. Of the 171 companies receiving waivers, 52% received less than \$15,000 and 14% received more than \$50,000.

Although the figures indicate that the utilization of the program was higher last year than in 1994/95, this does not alter our view that the program acts as a subsidy in an environment where subsidies and incentive programs are seen as unnecessary and undesirable.

In addition, eliminating the tracking and processing of rental waivers would allow us to improve our service and response time in other areas.

Proposal:

Eliminate rental waivers for licences sold after the new regulation becomes effective (spring/summer of 1997). Rental waivers will continue to be available for all licences that are sold prior to that date. We believe this compromise allows the Department to achieve its objectives in a way that does not affect existing licensees.

5.3 Plains Licences

Background:

The P & NG Agreements Regulation currently provides for a maximum size of 29 sections for agreements in the Plains area. The Department suggested that the maximum size should be reduced to 15 sections, as larger postings tend to discourage competitive bidding. An alternative suggestion was that Licences should no longer be available in the Plains area, on the grounds that most of the activity taking place was developmental rather than exploratory in nature.

The feedback we received indicated that many people still regard licences as valuable tools in all areas of the Province. We have therefore amended this section of the proposal so that licences are still available in the Plains area. However, the maximum size of both leases and licences is restricted to ensure that there is equal opportunity for access throughout the industry.

Proposal:

Reduce the maximum size of leases and licences, in the Plains area only, from 29 sections to 15 sections.

5.4 Zone Severance for Licences

Background

The P & NG Agreements Regulation specifies that a well drilled on a licence to evaluate petroleum and/or natural gas rights granted by the licence is deemed to be a lease-earning well. The amount of lease earned by any well is based on a table contained in the regulation, which grants a certain number of sections for specified depths drilled. The leases that are granted presently contain all the same rights that were contained in the licence.

This proposal originally contemplated severance at the base of the deepest zone evaluated by the earning well. The feedback that was received indicated an even split between support for this concept and opposition to it. We felt that, although it would be a logical step in the progression of deeper rights severance, it would also create a significant additional workload for both the Department and industry. In view of the increased workload that we will encounter in 1998 with respect to lease continuation, it was decided that this concept should not be implemented at this time.

Proposal:

The current system will be retained: leases that are earned from licences will contain all the rights that were granted by the licence.

The following two proposals 5.5 and 5.6 are included in this document in the interests of presenting a complete picture. Both have been previously circulated through industry, and both were implemented effective May 7, 1996, by Information Letter 96-14.

5.5 Lease-Earning Status of Re-Entry Wells on Licences

Background:

The re-entry of an existing suspended or abandoned well is sometimes an inexpensive alternative to the drilling of a new well. The Department considers that one of the few remaining distinctions between leases

and licences is that a licence requires the drilling of a well; it is the action of drilling that earns lease rights, whether or not the lands are productive. However, we have no wish to force the drilling of an unnecessary well if there is an existing wellbore that can be deepened.

Proposal:

Allow re-entries of existing wells to earn leases provided that additional footage is drilled. The approval of the re-entry as a lease-earning well could be obtained at any time before, during or after the re-entry operation. An extension of 150m or more would automatically earn leases in accordance with the well's new measured total depth. An extension of less than 150m would earn leases only if the Department determined that the operation yielded significant new information.

This proposal contemplates that a re-entry will not earn leases if it simply re-evaluates or tests a zone that had already been penetrated and logged. In this situation, the Department will issue a lease, pursuant to Section 16[a] of the Act, for the spacing unit for a productive well.

5.6 Lease-Earning Status of Horizontal and Directional Wells

Background:

The Department presently uses the true vertical depth (TVD) of all wells to calculate lease entitlement, thus effectively eliminating horizontal and directional drilling from consideration. At the meeting held on November 23, 1995, some industry representatives suggested that the regulation should keep pace with technology, and acknowledge the value of horizontal and directional drilling by according it lease-earning status.

Proposal: To allow horizontal and directional drilling to earn leases from licences. The measured total depth (MD) would be used instead of the true vertical depth (TVD) of the well for the purposes of calculating lease entitlement. This would automatically include the horizontal portion of a wellbore as well as the entire wellbore of a directional well.

6. Proposal to Eliminate P & NG Licences

Background:

Information Bulletin 96-3, published May 1, 1996, introduced the concept of eliminating licences. We believed that the issue had not been adequately explored when it was first raised in September 1995, and that it deserved a more detailed examination. At the same time, we had received some valuable feedback on the current administration of licences. We therefore requested your input into the issue of whether we still need P & NG Licences in Alberta.

P & NG Licences currently comprise approximately 65% of the area and 25% of the agreements that are posted and purchased in Alberta (fiscal 95-96 figures). A licence carries a heavy administrative burden, not only during its term (rental waivers, groupings), but when it expires and is either cancelled or converted to lease (47% of the agreements and 49% of the hectares are converted to leases). Our initial proposal suggested that the conversion of earned rights into lease agreements was time-consuming, and that the issuance of a new agreement opened the door for new surface access restrictions to be applied. We had therefore proposed to replace licences and leases with a single, more flexible agreement having a fixed term in the Plains and variable terms in the Northern and Foothills areas.

However, much of the feedback received to this proposal was negative, with several respondents commenting that P & NG rights were likely to turn over more slowly. Some also suggested that the administrative burden would not be significantly lessened by the proposal. Our own subsequent review of the current business processes tended to support this view.

On the basis of the feedback we received, we are satisfied that retaining the current licence-lease system is in the best interests of the industry at present, and Part I of this document will be used to proceed with the

drafting of the amendments to the P & NG Agreements Regulation. The Department will probably review the elimination of the licence agreement again with industry at some future date, to determine whether the licence-lease system continues to meet our respective needs.