

Chapter 5

Assessing Production

Continued Leases

When a lease is continued, it is classified as

- producing
- or
- non-producing

Non-producing continued leases are subject to escalating rents. The payment schedule and requirements are discussed in [Chapter 6](#).

Oil Sands Tenure Regulation, section 1(q)

A producing lease is one in which “oil sands are, in the opinion of the Minister, being produced from a zone or zones in the location of the lease.” The regulation takes an all or nothing approach: it makes no provision to designate part of a continued lease as producing and part as non-producing. This reduces the administrative burden both for industry and for the department.

Minimum Levels of Production

In order for producing status to be assigned, a lease must meet a department-defined minimum level of production (MLP). This benchmark was established after the department reviewed the production histories of a representative sample of leases from each oil sands area.

The required minimum level of production per term year* is 2,400 m³ of bitumen per section (40 barrels per section per day), on average, over the lease term.

Oil Sands Tenure Regulation, section 14

Second- and third-term leases which are subject to approved development plans, and which are meeting the milestones specified in these plans, are considered to be continued producing leases.

MLP is calculated as an average for the entire lease, not on a section-by-section basis. Nevertheless, as shown in [Figure 9](#) and [Figure 10](#), the calculation considers all of the sections included in a lease.

For a primary lease, MLP is calculated as the average production in the final 12 months of the lease term. For a continued lease, the MLP is calculated as the average production in a term year. See [MLP example](#)

The MLP requirement is the same for all leases, regardless of the type of recovery (mining or in situ) used.

Note

If the required MLP has not been attained, a lease is subject to escalating rent. See [Chapter 6](#) for details.

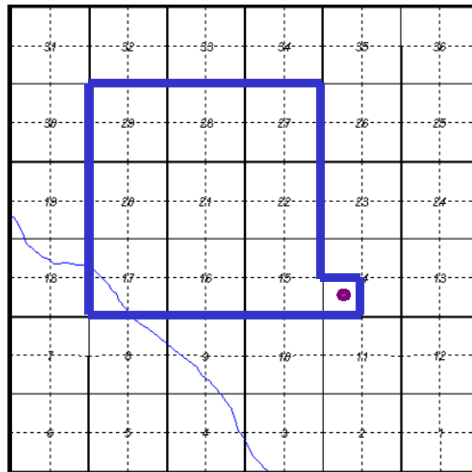


Figure 9: This lease includes 9.25 sections. The MLP requirement is 2,400 m³ per section. This means that MLP is achieved if production from the lease meets or exceeds 22,200 m³ per year (9.25 x 2,400)—even though all the production is coming from a single well producing at a rate of 1,850 m³ per month

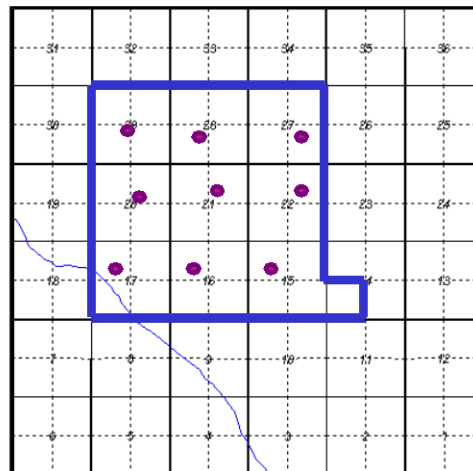


Figure 10: Although this 9.25-section lease has a producing well on nearly every section, MLP is only achieved if the total production from the lease meets or exceeds 22,200 m³ per year—that is, 9.25 x the required minimum of 2,400 m³ per section. Even though production from some wells might exceed this minimum, the MLP calculation is based on the lease as a whole. For example, if three wells each produced 2,400 m³ per year and six wells each produced at 2,000 m³ per year, total production for the lease would be 19,200 m³. This is not enough to meet the MLP requirement.

Production Criteria

MLP is the only criterion used to determine the producing status of a lease. The following measures are not accepted:

- recoverable reserves or functions of recoverable reserves,
- royalty payment,

Royalty is attributed to individual wells at any level of production. Since royalty is not necessarily related to the lease as a whole, it is not an appropriate indicator of MLP.

- assessments of sales versus operating costs, and
- ERCB-approved schemes.

Schemes may incorporate all or portions of several leases in a variety of permutations which may be amended from time to time. While leases covered under ERCB schemes are approved for production, production is not required.

Changing a Lease Designation

Producing to Non-Producing

A producing lease is redesignated as non-producing if it has produced below the required MLP in each of three successive term years.

Lessees are notified if the department has reason to question the producing status of a lease. If producing status no longer applies, the department issues a notice advising that the lease status will be changed to non-producing.

Lessees may respond to a change-of-status notice in three ways:

- They may submit information that demonstrates production.
See [Minimum Levels of Production](#) for criteria defining minimum levels of production.
- They may surrender their lease.
See [Surrender](#) for details.
- They may choose to accept the change in designation and begin to pay escalating rent according to the prescribed schedule.
See [Chapter 6](#) for details.

Oil Sands Tenure Regulation, section 22(2)

The change from producing to non-producing status takes effect on the term anniversary date of a lease. The entire lease is subject to escalating rent as of this date.

For example

A primary lease is continued as producing on October 14, 2001. For the next three years (2001–2002, 2002–2003, 2003–2004), the lease does not deliver the required minimum level of production. The department issues a notice of non-producing status on November 4, 2004. The change is effective as of October 14, 2004. Escalating rent is payable for the term year October 14, 2004 to October 14, 2005. Escalating rent is payable every subsequent year, until such time as the lease is re-designated as producing.

Section 22 is discretionary: the Minister may choose not to invoke it if a lessee can demonstrate that production is in decline prior to well abandonment.

Production Cycling

Oil Sands Tenure Regulation, section 21 and 22

The *Oil Sands Tenure Regulation* make it possible for a lease to maintain its producing designation if production meets the MLP requirement for one year, but falls short for two immediately following years. Such production cycling would most likely occur in the case of wells using primary recovery methods. The cycle could be repeated indefinitely to avoid having the lease redesignated as non-producing—and to avoid paying escalating rent.

“One-on, two-off” cycling is inconsistent with the requirement for diligent, continuous production, which is implicit in the regulation.

Oil Sands Tenure Regulation, section 23

The Minister may require a lessee to increase production, within a certain period, to a prescribed level. This provision overrides MLP criteria and can be used to prevent the use of production cycling as a means of avoiding a non-producing lease designation.

Non-Producing to Producing

Lessees may apply to have their leases reclassified from non-producing to producing status. It is the lessee's responsibility to inform the department if producing status requirements have been met.

Requests to reclassify a non-producing lease as producing must be supported by technical data which verifies production. Department staff will use the Petroleum Registry of Alberta to confirm if production levels meet the required minimum levels of production.

Requests to reclassify a lease as producing are reviewed within 30 days of receipt. If minimum levels of production were met or exceeded for the preceding term year, the department reclassifies the non-producing lease as producing. The newly assigned producing status takes effect on the next term anniversary date. Escalating rent applies until the current term year is complete.

For example

If a continued producing lease does not deliver the required minimum level of production for three consecutive years, the department classifies the lease as non-producing as of its term anniversary date October 14, 2004. In 2006, production levels exceed the required minimum and the lessee applies to have the non-producing lease changed to producing. The change is approved by the Minister and takes effect on the next term anniversary date, October 14, 2007. Escalating rent does not have to be paid for the term year October 14, 2007 to October 14, 2008—or for subsequent years, as long as minimum level of production is maintained.