

# THE NEGOTIATOR

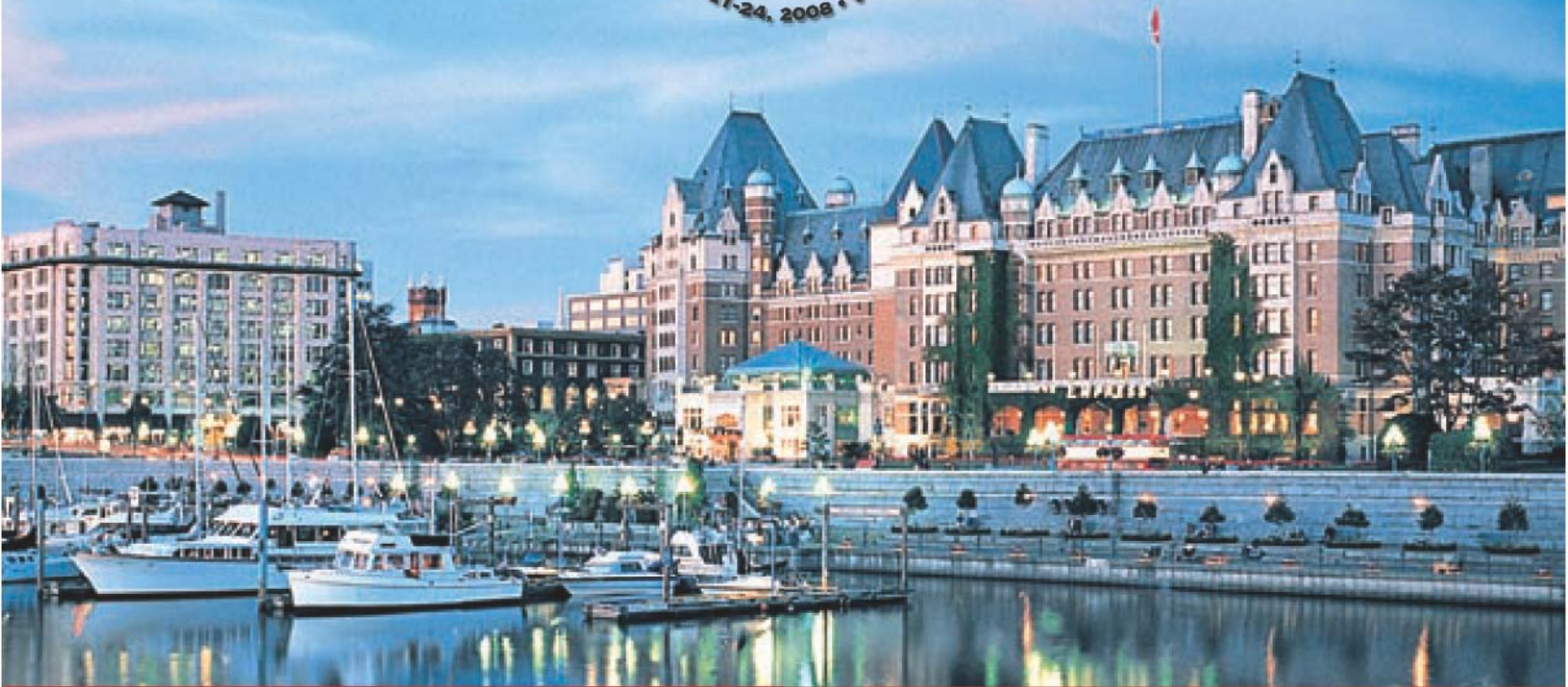
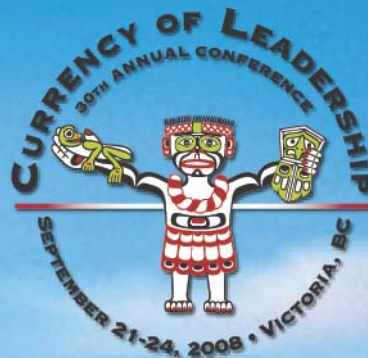
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The Magazine of the Canadian Association of Petroleum Landmen

June 2008

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# 2008 CAPL CONFERENCE



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## Production Allocation Unit Agreements

The Single Well Unit



# Production Allocation Unit Agreements (The Single Well Unit)

The traditional unit agreement and the Production Allocation Unit Agreement (PAUA) are, in my humble opinion, truly magnificent legal documents that:

- (a) allow for the equitable and economic production of oil and gas where you have diverse working interest (WI), royalty (GOR) and lessor (LOR) parties in a pool(s) or well;
- (b) provide a mechanism for regulatory compliance where you do not have common ownership in a pool or where you are commingling production among pools and spacing units; and
- (c) increase lease continuation certainty through the amendment of the leases to provide for continuation by way of unit operations.

The increase in horizontal well drilling has been the driver in the use of PAUAs. A PAUA is required in horizontal wells where the productive horizontal legs cross more than one spacing unit and there is varied WI, GOR or LOR parties.

However PAUAs may also be used for vertical wells, where parties are increasingly producing from multiple pools within a single wellbore and commingling production to a single meter

point. This vertical commingled production from multiple pools is more than a vertical pooling (since each pool is a separate spacing unit), so a PAUA should be used.

## Common Ownership

The regulatory requirement of common ownership in a spacing unit or larger production unit is the bedrock rationale for PAUAs (see for example the Oil and Gas Conservation Regulations, Alberta). Regulatory bodies require that production occur equitably among the WI and LOR owners. Failure to establish common ownership in a spacing unit or larger production unit is a non-compliance event and can lead to shutting in wells and other regulatory woes.

Where you have varied WI or LORs in production from a single wellbore, equitable production can only be assured where the parties have agreed to the method of allocation of such production. This is especially the case where production from each horizontal leg or vertical completion cannot be individually determined or metered. Where you cannot actually measure production from tracts having differing ownership, the only method to equitably allocate production among owners is by way of a PAUA which allocates production from the production allocation area to the various tracts.

## Freehold Lease Continuation

The other fundamental benefit of unitization is the ability to amend freehold leases to provide for continuation by way of unit operations as opposed to actual operations from the said lands under the lease. A PAUA should always contain an article on lease continuation and amendment. A good example is the Alberta Energy model form PAUA (which can be downloaded from the AE website, under Tenure forms). Article 9 of this PAUA provides that:

### 9.1 Continuation of Leases

All operations conducted with respect to the Production Allocation Zone or production of Production Allocation Substances shall, except for the purpose

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of calculating payments to Royalty Interest Owners, *be deemed conclusively to be operations upon or production from the Production Allocation Zone in each Tract, and such operations or production shall continue in full force and effect each Lease and any other agreement or instrument relating to the Production Allocation Zone or Production Allocation Substances as if such operations had been conducted on, and a well was producing from, each Tract or portion thereof in the Production Allocation Area (emphasis is mine).*

#### 9.2 Leases Amended

Each Lease and any other agreement or instrument relating to the Production Allocation Zone or Production Allocation Substances is hereby amended only to the extent necessary to make it conform to this Agreement.

These magic words must appear in your PAUA in order to properly amend your lease and the lessor must be a party to and sign the PAUA. You cannot bind the lessor unless they have agreed in writing to the amendments to the lease.

Please note that such an amendment must also be caveated on title in order to be enforceable as against third parties. The original

lease caveat can protect only the terms of the original lease, not amendments. Failure to file such a caveat could lead to a top lessee successfully lapsing your original lease caveat if you do not have production from the said lands under your lease.

#### Special Consideration for GOR

An often overlooked element of common ownership on unitization is the GOR holder. Such parties are often but not always included as parties in the unit agreement such that the GOR holder's royalty is calculated based upon unit production

#### Calculating the GOR

You cannot assume that a GOR is always paid based upon unitized production. You must confirm that the GOR holder was a party to and signed the PAUA. In such a case the GOR will appear as a royalty or encumbrance beside the appropriate tracts in the unit Exhibit. If so, the GOR is calculated based upon unitized production.

However, if the GOR holder did not sign the unit agreement, the GOR is not payable based upon unitized production but rather from production from the GOR lands. This can lead to bizarre results in traditional units depending on where the GOR lands are located. Sometimes a GOR holder will refuse to sign onto a unit as a major well is located on the GOR lands. In such a case the GOR will continue to be calculated from production from such



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well, regardless of the impact of waterflood or other enhanced recovery techniques pushing additional oil through the wellbore. Often after a number of years (and sales of the assets) the GOR stops being calculated based upon the said lands and starts to be paid on unitized production. Not ok.

#### *GORs and Common Ownership*

A potential common ownership issue can also arise if GOR holders are ignored on unitization. As indicated above, PAUA are often used where it is not possible (or economic) to determine the volumes of production from each leg or completion over time as all volumes are measured at a single meter. If a GOR holder is not a party to a PAUA in such a case, they can certainly argue that common ownership has not been established. The rationale for common ownership is equitable production. If a GOR holder cannot establish the share of production from the wellbore that the GOR pertains to, the GOR holder cannot be equitably compensated. This will at least lead to a lawsuit and perhaps regulatory non-compliance measures.

In my practise I run across very few new wide area unit agreements. It seems a shame not to take advantage of unitization in any situation possible. This is especially the case where companies are undertaking enhanced recovery projects (such as complex water floods or CO2 projects) on a pool wide basis on older well defined pools. In such situation a unit will allow for common ownership and tenure certainty in undertaking costly and long term projects.

The good news is that the PAUA seems to have become an industry standard document that horizontal well operators use on a day to day basis. Hopefully we will come to see increased use of the PAUA in vertical well commingling situations. ☰

*Paul Negenman*  
*Partner, EnerLaw LLP*

# 31st Annual CAPL Trap Shoot

The 31st Annual CAPL Trap Shoot will be held at the AHEIA Calgary Firearms Centre (near DeWinton) on Saturday September 13, 2008. Competition will start at 9.00 AM and consist of two 16 yard events, a slider, a final handicap event, and, as usual, buddy shoots and Annie Oakleys.

Registration fees will remain the same as last year at \$106.00 for CAPL members, \$95.00 for students, and \$117.00 for Guests (GST included). The registration form and waiver of liability must be downloaded from the CAPL website. The Trap Shoot Committee would appreciate receiving your completed registration form, waiver of liability, and fees as soon as possible. New shooters and sponsors are always welcome.

The fee includes 100 competition targets (12 gauge shells provided), beverages, lunch, awards, and the special event shoots. Award presentations and refreshments will follow the shoot. Entries are limited to 80, so please pre-register as soon as possible.

The primary purpose of the shoot is to network and have a safe, enjoyable time while attempting to break as many clay targets as possible. It's also great practice if you plan to go bird hunting this fall.

All skill levels, from beginner to expert, are welcome. CAPL members interested in finding out more about the sport of trapshooting can contact any of the members of the Trap Shoot Committee for additional information. Shotguns are available at the Firearms Centre for use by non-owners for a nominal fee. ☰

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