

August 1, 2013

## **Kallisto # 2. Competing Uses of Geological Space: Resolving Conflicts Between Oil Production and Natural Gas Storage Interests**

**Written by: Nigel Bankes**

### **Decision commented on:**

Kallisto Energy Corp Application for a Well Licence, Crossfield East Field, July 23, 2013, [2013 ABAER 013](#).

In a sequel to the ERCB's Decision, Kallisto Energy Corp Application for a Well Licence Crossfield East Field, [2012 AERCB 005](#), February 24, 2012 (hereafter Kallisto # 1), the subject of an earlier ABlawg [post](#), the new Alberta Energy Regulator (AER) has handed down its decision on a proposal by Kallisto Energy to drill another oil well on lands immediately adjacent to CrossAlta's natural gas storage facility north of Airdrie.

The proposed well is in LSD 16 in the extreme NE quarter of section 26 just outside the boundaries of CrossAlta's storage unit which includes the diagonally offsetting section 36. One important difference between this application and the earlier application was that in the earlier application Kallisto was aiming to produce from the Basal Quartz Formation (in the SE quarter of the same section) whereas in this case Kallisto aims to produce from the Elkton Formation which is the same formation which CrossAlta uses for storage. Kallisto acquired the rights to the NE quarter from the Crown.

The AER approved the application subject to a number of conditions relating to the manner of drilling and completing the well, abandonment of the well, measurements to be taken, the disclosure of certain confidential information about the well to both CrossAlta and neighbouring mineral owners, and production reporting requirements.

This post comments on several aspects of this important decision.

### **Principles to guide this and future decisions related to balancing gas storage interests and oil and gas production interests (both working interests and owners)**

The ERCB, the predecessor of the AER, often recited the objects clauses of its constituent legislation but it rarely developed more specific principles to guide decision-making in a particular area. In this decision however, the AER explicitly articulated three principles to help guide decision-making in this and similar future applications (at paras 85 – 87):

First, storage operations benefit the public and are an important part of the natural gas system in Alberta.... However, the panel finds that the risk to the integrity of the gas storage reservoir must be balanced with the right to explore for and

develop hydrocarbon resources near the storage reservoir. Such development is in the public interest and should occur where the risk can be managed.

Second, the boundaries of the storage unit may change based on evidence from new developments.... legislation allows CrossAlta, as the storage operator, to file applications to expand its approval area based on such new evidence.

Third, the storage operator is responsible for monitoring development around its gas storage unit and for taking steps to expand the boundaries when new information confirms there is a need to do so.

But while these principles are useful, they certainly are not comprehensive and do not address all of the issues raised by the application. Read together they suggest that storage operators need to be proactive and take steps to protect their interests rather than simply responding defensively to applications brought forward by others.

### **The rights of the parties**

In making its application, Kallisto clearly contemplated that its well might produce, in association with any oil Kallisto might find, some of CrossAlta's storage gas. The panel too acknowledged this possibility (at paras 53 – 57). Kallisto did not claim rights to this natural gas through the terms of its lease with the Crown. Indeed it acknowledged that if it did produce storage gas it would have a duty to make CrossAlta whole and proposed a series of measures to that end including (at para 74) that it could:

- re-inject an equivalent heat value of storage gas produced from the 16-26 well into the gas storage operation, at Kallisto's expense, into an existing scheme well or a new well;
- return the storage gas to CrossAlta after processing the gas, place it into the Nova market pipeline system, and attribute a volume of the processed gas to CrossAlta on an equivalent heat value basis...., or
- become a regular storage customer whereby Kallisto can commit to maintaining a volume of gas in the storage operation sufficient to offset any volume of storage gas produced in the 16-26 well ...

But by the same token, Kallisto clearly did not concede that CrossAlta was entitled to have the AER reject its application if it found that there was some risk that Kallisto might interfere with CrossAlta's property (see CrossAlta's position at paras 17 and 31). Kallisto took the view that "the right to work" line of cases (see in particular *Alberta Energy Company Ltd v Goodwell Petroleum Corporation Ltd*, [2003 ABCA 277](#)) allowed it to interfere with the property rights of others (at paras 18 – 19) (subject presumably to the AER's approval and through terms and conditions designed to balance the interests of both parties, see para 12). In jurisprudential terms (see Calabresi and Melamed, "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral" (1972), 85 Harv L Rev 1089) we might say that Kallisto conceded that CrossAlta had a liability entitlement but not a property entitlement, and that Kallisto was content for the AER to map out the contours of the liability entitlement. CrossAlta's position is that it has a property entitlement that it can, if necessary, protect by means of an injunction.

The AER clearly sided with Kallisto on this issue and in doing so probably sets up a nice point of law for consideration by the Court of Appeal insofar as the AER expressly ruled that the right to

work cases apply equally to both native hydrocarbons and stored hydrocarbons (at paras 32 – 33). There is no Canadian authority precisely on point.

### **Buffer zones**

As in Kallisto # 1, CrossAlta argued that it had the right to be protected from the risk of drainage through the creation of a buffer zone around its approved unit. It based its argument, in part at least, on the idea of settled expectations. But the AER would have none of that, pointing (at para 38) to both its own Directive (Directive 065, Resources Applications for Oil and Gas Reservoirs, s 4.3.3) and the Crown’s own policy (at para 39) to make it clear that CrossAlta had been put on notice that it was up to the storage gas operator to take measures to protect its own interest, although as in Kallisto # 1 the Regulator does recognize (at para 114) that this is difficult for an operator to accomplish, especially where the offsetting rights are owned by the Crown.

### **Measures to protect the integrity of the gas storage facility**

While the AER dismissed CrossAlta’s property entitlement claim it was clearly prepared to take significant measures to protect CrossAlta’s liability entitlement. Indeed, many of the measures imposed by the AER are designed precisely to ensure that CrossAlta suffers no harm. In imposing these conditions the AER was for the most part simply adopting what Kallisto was proposing to do in any case. For example, Kallisto voluntarily committed not to fracture stimulate the well and to complete the well in accordance with Directive 051 (at para 91). Similarly, the AER largely accepted Kallisto’s proposals (at para 61) to go beyond the current regulatory requirements for abandonment so as to ensure the continued integrity of CrossAlta’s storage operation. The AER summarized its assessment of the net effect of these conditions at para 107: “The panel finds that the drilling, completion, and abandonment of the 16-26 well, in accordance with the conditions outlined above, would not affect the functional integrity of CrossAlta’s gas storage unit.”

### **Measures to deal with the implications of producing storage gas**

The parties expressed very divergent views on how to deal with the possibility that Kallisto’s well might produce storage gas. In crafting its response the AER recognized that it faced some jurisdictional constraints in terms of any solution that it might impose. Consequently, the AER focused on imposing a set of requirements that would provide the parties with an information base that would help them reach a voluntary agreement, or, alternatively, provide a basis for resolving any remaining issues through litigation. To that end, the AER imposed a set of conditions including a requirement to conduct an initial pressure test, and a set of measurement and reporting requirements the effect of which the AER summarized as follows (at para 107):

The panel also finds that measurement conditions placed on the licence will ensure that the parties have the information they need to identify the nature of fluid produced at the 16-26 well and reach an arrangement, either voluntarily or through the courts, that reflects the rights and interests of each party.

While the AER indicated that Kallisto had a duty to return to CrossAlta any storage gas that it might produce (at para 97), it declined to impose a specific condition to that effect or indicate a particular mechanism for effecting such a return. It did however comment on Kallisto’s proposals finding them “reasonable” and noting in particular (at para 99) “that if Kallisto presupplied gas to CrossAlta’s gas storage unit in quantities greater than or equal to the heating

value of the gas produced, the gas produced from the 16-26 well could be considered its own and not that of any other gas owner.” The AER however did not believe that it had the jurisdiction to *impose* such a solution and offered detailed reasons for that conclusion, examining a number of different possible sources of authority under the *Oil and Gas Conservation Act*, [RSA 2000, c O-6 \(OGCA\)](#).

The AER first considered s.38 of the *OGCA*, which deals with the AER’s authority to prevent waste.

In order to prevent waste, the Regulator, with the approval of the Lieutenant Governor in Council, may

(a) require enhanced recovery operations in any pool or portion of a pool, and for or incidental to that purpose require the introduction or injection into the pool or portion of a pool of gas, air, water or other substance or a form of energy, and

(b) require that any gas, on its production, be gathered, processed if necessary, and the gas or products from it marketed or injected into an underground reservoir for storage or for any other purpose.

The panel commented as follows on that section:

.... clauses (a) and (b) of section 38 are not alternatives, as Kallisto seemed to be arguing by only relying on section 38(b). The panel understands that Kallisto requested this condition not to require itself to undertake any action but to order CrossAlta to enter into certain agreements. The panel understands that this is clearly not the intended purpose of section 38, which is to authorize the AER to order an approval holder to commence enhanced recovery operations and re-inject its gas into a pool in order to prevent waste. The panel understands that since Kallisto’s proposed mitigation would be to return CrossAlta’s property to “keep it whole” and would not primarily be to prevent waste, section 38 would not apply.

The panel next turned to consider (at para 102) whether it could “order re-injection by CrossAlta [so as to] create a gas cycling scheme that involves multiple units operating in conjunction” but concluded that it could not because such an order “would constitute a de facto unitization” (I’m not sure that I see that) and since the government has not proclaimed the compulsory unitization provisions of the Act that too would be beyond the power of the Regulator. Thus, while “it would be desirable from an orderly and efficient development perspective to have CrossAlta and Kallisto work together in such a manner that would allow the production of any oil at the 16-26 well, the AER does not have the jurisdiction to order the parties to do so.”

The AER also discussed s 99 of the *OGCA* (dealing with compensation schemes) which last saw the light of day in the gas over bitumen wars (see *Gulf Canada Resources Ltd v Alberta*, [2001 ABQB 286](#)) but as the panel points out (at para 103) that is a section that must be triggered by the Lieutenant Governor in Council and the AER had received no such direction.

### **The duty to provide third parties with confidential information**

One of the more unusual conditions that the AER imposed on Kallisto in this case was a duty to provide confidential information to CrossAlta and to intervening freehold mineral owners who

owned the mineral rights to other tracts within the section. The two interveners both supported Kallisto's application since they were clearly concerned that CrossAlta's arguments, if successful, would sterilize their lands from possible oil exploration and production (and royalties) without compensation. The scenario in which this obligation would be triggered would be one in which Kallisto's well discovered a new pool since in such a case the well results would be confidential for one year (at para 97). While the AER justified this condition on the grounds that it is in everybody's best interest (see at paras 97, 106 and 113) to understand whether additional lands should be included within the storage unit it is not clear to me that the AER has the jurisdiction to make such an order. At the very least the point deserved the same scrutiny that the panel extended to the proposals for having the AER make an order prescribing how the parties should deal with produced storage gas.

### **Access to the application material**

Regular users of the AER\ERCB website and readers of ABlawg will be aware that the application materials that lead to AER\ERCB decisions are typically posted on the [AER's website](#) during the application period and for 30 days thereafter. I am guessing that there will be a lot of interest in this material and I would ordinarily, as I have before (see [here](#)) urge you to run to the AER website and get this material easily while you can. But I am afraid that in this case you, like me, will be disappointed - because it isn't there. I've seen this happen before so it is not new to the AER, but it would be nice to know what the policy is that leads the AER (and the ERCB before it) to post some application material and not other material. It certainly isn't confidentiality (some material is rightly withheld as being confidential) since the notation on the Integrated Application Registry (IAR) display page says for most of the material "Public Record: This attachment is available only through a request at Information Services at the AER head office." I have railed before about the ERCB's lack of transparency and its poor website and I was hoping (naively I suppose) that things would be better with the AER. But I have not seen much to support that hope. The AER's website is even harder to navigate and find material on than the ERCB's old site: just one example, AER decisions on the new website are now buried under the heading "Applications and Notices": see <http://www.aer.ca/>

*For further discussion of natural gas storage law in Canada see Bankes and Gaunce, [Natural Gas Storage Regimes in Canada: A Survey](#), December 2009; and, related to this post and available upon request (via email to [ndbankes@ucalgary.ca](mailto:ndbankes@ucalgary.ca)), Nigel Bankes "Disputes between the owners of different sub-surface resources" a final draft of a chapter for an edited volume to be published by Oxford University Press, Spring 2014.*

To subscribe to ABlawg by email or RSS feed, please go to <http://ablawg.ca>

Follow us on Twitter @ABlawg

