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The Crown Pore Space Lease and Pore Space Unit Agreement

By: Nigel Bankes

Documents commented on: The Crown [Pore Space Lease](#) and [Pore Space Unit Agreement](#)

As I discussed in my [last ABlawg post](#) the Government of Alberta (GoA) recently announced the adoption of the Small-Scale and Remote (SSR) Carbon Sequestration Tenure. As part of this announcement, the GoA also released a standard form pore space lease (PSL) and a model Pore Space Unit Agreement (PSUA). This is my attempt to unpack these two agreements and to offer what I hope will be understood as constructive comments on these documents.

The Pore Space Lease Form

The Pore Space Lease form consists of a short preamble, a combined granting clause and *habendum*, a statement of the relationship between the lease and relevant legislation, a set of definitions, and one additional operative article that establishes a total of eight conditions. An appendix to the lease describes the commencement date, the description of the lease location, and the injected substances.

The Preamble contains a single recital to the effect that “His Majesty is the owner of the pore space in respect of which rights are granted under this Lease”.

The granting clause stipulates that “His Majesty grants to the Lessee, insofar as His Majesty has the right to grant the same, the exclusive right to utilize the pore space to sequester Injected Substances within the Location, subject to the *Mines and Minerals Act* ...”. “Injected Substances” are defined as “any substances which the Regulator [i.e. the Alberta Energy Regulator (AER)] may authorize the Lessee to inject”. The grant is an exclusive grant of the right to utilize the pore space for sequestration purposes – but only for those substances authorized by the AER. The drafter seems to have conflated two different ideas here: the exclusive nature of the sequestration right and the substances that can be injected. Read literally, if the AER only provides approval for the injection of carbon dioxide, the Crown could still authorize use of the same pore space for the injection of oilfield waste. That does not make any sense.

The grant and *habendum* are subject to two reservations. The first is a reservation of rent as prescribed by the *Mines and Minerals Act*, [RSA 2000, c M-17 \(MMA\)](#). The second is a reservation of any compensation for the use of pore space or for injected substances as prescribed by the *MMA*, “specifically including but not limited to required payments into the Post-Closure Stewardship Fund, any and all liability management fees, levies, charges or payments.” This is a rather strange provision to see in the PSL for a couple of reasons. First, the Post-Closure Stewardship Fund applies to leases and agreements granted under Part 9 of the *MMA*. There are good reasons to think

that a PSL is granted under s 15.1 of the *MMA* (the pore space vesting provision) rather than Part 9 of the *MMA* – and this is certainly the case for the PSUA. Second, liability management fees are more appropriately a function of the regulatory framework administered by the AER than a function of Crown ownership of pore space.

The *habendum* (that is to say the duration of the grant, the estate for which the grant is made) is said to be for so long as the Pore Space Unit Agreement associated with the lease “remains in existence”. I will return to this point below, but it seems to suggest that you can’t have a pore space lease unless you have a PSUA. That presents something of a chicken and egg problem: i.e. how do you negotiate a PSUA unless you have a pore space lease? And if you don’t have a PSUA in effect on the commencement date of the lease does your lease automatically terminate?

The lease clause dealing with the relationship between the lease and the underlying legislation will be familiar to all who have dealt with Crown leases over the decades. It is an ambulatory reference to the *MMA* and other relevant legislation (and regulations) as they exist from time to time:

In this Lease, a reference to the *Mines and Minerals Act* or to any other Act of the Legislature of Alberta referred to in section 2(2)(b) of this Lease shall be construed as a reference to

- (a) that Act, as amended from time to time,
- (b) any replacement of all or part of that Act from time to time enacted by the Legislature, as amended from time to time, and
- (c) any regulations, orders, directives, or other subordinate legislation from time to time made under any enactment referred to in clause (a) or (b), as amended from time to time

The lease is granted on eight conditions (although some of these items read more like definitions or interpretive notes rather than conditions). The first is a condition on paying the reserved rent and other compensation. The second requires compliance with the *MMA* and the *Oil and Gas Conservation Act*, [RSA 2000, c O – 6](#) (*OGCA*), and any other relevant Acts. A third “condition” indicates that these statutory provisions are deemed to be incorporated into the terms of the lease, while a fourth condition indicates that in the event of a conflict between the terms of the lease and applicable legislation, the legislation shall prevail. The fifth condition is a standard clause in an Alberta Crown lease indicating, effectively, that if the lease is held by a Crown corporation that seeks to claim immunity from the application of provincial laws, it shall be deemed to be in breach of this condition of the lease. That is a true condition. Condition six is an indemnification clause, while “condition” seven is designed to ensure that the language of lease in the document does not create “any implied covenant or liability” on the part of the Crown or the relationship of landlord and tenant. Condition eight refers to any special provisions that might be included in the Appendix to the lease. Again, and as noted above, many of these provisions should not be labelled as “conditions”.

In sum, apart from the *habendum*, the lease form will look pretty familiar to those who are used to dealing with Alberta Crown petroleum and natural gas leases.

The Pore Space Unit Agreement

The Pore Space Unit Agreement (PSUA) evidently draws on two precedents: (1) the proprietary form of unit agreement developed by the Petroleum Joint Venture Association ([PJVA](#)), and (2) the Crown's [Gas Storage Unit Agreement \(GSUA\)](#).

The PSUA consists of seven preambular paragraphs, eleven operative articles, and four exhibits or appendices.

Article I, "Interpretation", consists of a set of definitions and some other matters including a statement of the relationship between the PSUA and legislation (essentially identical to the clause in the lease quoted above). It also contains a unique clause headed "Regulatory Framework":

Except where a contrary intention is expressly indicated in the body of this Agreement, the Parties acknowledge and agree that any and all Unit Operations are subject to all applicable law and for clarity, unless expressly exempted, the Parties are bound to comply with any legislation that applies to this Agreement at any time, including but not limited to any applicable royalty, fees, tariffs or liability management unit charges. (at cl 106)

The "Parties" to the PSUA are described in the Preamble as those who own "Working Interests in the Unitized Zone" but later, in the definition section, "Party" is defined as "a person who is bound by this Agreement, whether or not the person is a signatory to this Agreement". I take it that this formulation is principally intended to capture those who take by way of assignment under the terms of Article VIII, Transfer of Interest, and cl 906 – the Inuring Clause, but it is perhaps also the means by which the Crown becomes a party to the agreement insofar as the signature page clearly contemplates that the Crown will be executing the agreement (and the Crown will usually not be a working interest owner – see below).

The definition of Working Interest is based on the equivalent provisions in both the GSUA and the PJVA forms:

"Working Interest" means:

- (i) A profit a prendre or similar interest entitling the owner thereof to produce or sequester into the Formation(s), or
 - (ii) Any disposition of rights associated with a Crown or other sovereign ownership interest, or with a fee simple of similar freehold ownership estate, in respect of the [formation name] Formation(s) if such rights are not subject to an interest of the kind described in paragraph (i) of this subclause,
- but does not include a beneficial interest in a mortgage, charge or other security interest;
(PSUA at cl 101(q))

The principal point to note is that subclause (i) embraces parties who have *either* the right to produce *or* the right to sequester in the formation. Furthermore, the right to produce is not confined to a specific category of substances (e.g. petroleum substances - as in the PJVA Agreement) and thus might include not only parties with the right to produce hydrocarbons but also parties with brine production rights.

I take it that subclause (ii) is intended to embrace scenarios in which the fee simple owner (or Crown) has not leased out the relevant rights. This is a relatively easy concept to understand if the relevant rights are relatively clearly defined (e.g. production of petroleum substances); it may be more difficult to understand and apply in circumstances (as here) where the relevant rights are more broadly framed and heterogenous. It is also notable that if the concept of parties is defined solely in terms of working interest owners and unleased fee simple owners (or equivalent) then the term does not include royalty owners (who are included in both the PJVA form and the GSUA). Neither does the term “parties” appear to include those persons who may hold Crown injection authorizations under s 54 of the *MMA*. This is not quite congruent with the posted [Application Guidelines](#), which indicates that a completed PSUA should reflect the “varying interests” in the location, and that “interests” include “Crown mineral agreement *and authorization holders ...*”. (at 6, emphasis added.)

Article II of the PSUA lists and identifies the four exhibits or appendices to the agreement. Exhibit A will identify the different tracts included in the unit and the tract participation factor for each tract, the names of the working interest owners for the tract, and the relevant leases for the unitized zone within the tract. The PSUA defines the term tract quite unhelpfully as “a parcel of land described and given a Tract number in Exhibit ‘A’ ...” (at cl 101(k)).

The same term is defined somewhat more usefully in the *OGCA* at s 78(b) as “an area within a drilling spacing unit or a pool, as the case may be, within which an owner has the right or an interest in the right to drill for and produce oil or gas ...”. But our understanding of even this definition needs to be expanded in the current context to encompass the concept of the right to drill wells for sequestration purposes.

In a conventional (production) unit agreement the tract participation factor will be an undivided percentage interest in total production from the unitized zone. It will be calculated, or negotiated between the parties to the PSUA, by reference to such factors as the size of the tract, the underlying recoverable reserves for the tract, and porosity. These negotiations can frequently be complex and protracted. It is far less clear how the tract participation factor will be determined for the PSUA, especially when such a potentially broad range of production and sequestration interest are included in the mix. The posted [Application Guidelines](#) address this problem as follows:

In the completed Unit Agreement, only the unitized substance (i.e., pore space) will be accounted for in the working interest tract factor calculations (Exhibit A). (at 6)

I don’t find that guidance very enlightening.

Exhibit B will be a plat of the unit area and tracts and Exhibit C will be a well log identifying the formation or formations included in the unit.

Exhibit D states that it will contain “the methodology to calculate the amount payable to the Crown on any minerals determined by the Minister to be in the Unitized Zone.” Exhibit D itself simply says at the moment “methodology TBD”. The Application Guidelines in this case do provide additional, albeit limited, guidance to the effect that:

The treatment of remaining recoverable resources will be outlined in the Unit Agreement. The Unit Agreement provides for the payment of Crown resource considerations on remaining resources in the reservoir over a base amortization period. This amount will be indicated in the Unit Agreement, which provides the methodology for the payment of considerations. (at 6)

This suggests to me that the Crown intends to seek compensation for any Crown owned resources that are stranded as a result of pore space sequestration activities, but evidently this is still a work in progress. One is also left to wonder how this squares with s 39(1.1) of the *OGCA*, which seems to contemplate that the AER will not be able to approve at least a carbon dioxide disposal scheme whenever that scheme may prejudice oil and gas and gas storage activities (no mention of other mineral recovery operations):

The Regulator may not approve a scheme for the disposal of captured carbon dioxide to an underground formation under subsection (1)(d) that is pursuant to an agreement under Part 9 of the *Mines and Minerals Act* unless the lessee of that agreement satisfies the Regulator that the injection of the captured carbon dioxide will not interfere with

- (a) the recovery or conservation of oil or gas, or
- (b) an existing use of the underground formation for the storage of oil or gas.

Article III of the PSUA gives effect to the unitization.

On and after the Effective Date the interests of each Working Interest Owner in or in respect of the Unitized Substances and the Unitized Zone are hereby unitized in accordance with the provisions of this Agreement. (at cl 301)

Note that while the definition of Unitized Zone is agnostic as to whether the formation is being used for production or storage purposes, the concept of Unitized Substances is confined to “any substance agreed to by the Parties *to be injected into the Unitized Zone* subject to any and all approvals by the Regulator”. (at cl 101(o), emphasis added).

Article III goes on to provide as follows:

Any Unit Operations shall be deemed conclusively to be operations upon the Unitized Zone in each Tract, and any such operations shall continue in full force and effect each Lease and any other agreement or instrument relating to the Unitized Zone or Unitized Substances as if such operations had been conducted on each Tract or portion thereof, in the Unit Area.

If, at any time during this Agreement, any Lease subject to the MMA would expire or be cancelled for the sole reason that the Lease did not qualify for continuation and/or production as a result of this Agreement, that Lease shall, as of the Effective Date, be deemed to be continued or producing, as the case may be for the duration of this Agreement.

....

Each Lease and any other agreement or instrument relating to the Unitized Zone or Unitized Substances is hereby amended only to the extent necessary to make it conform to this Agreement. (at cl 303-304)

Unitization includes two key concepts: (1) a formula for dividing the benefits associated with having an ownership or working interest in the unitized area and resources, and (2) a mechanism for ensuring that every lease in the unitization is continued even though there may be no operations on a particular lease or tract. The tract participation formula discussed above gives effect to the first key concept. These provisions reproduced from Article III give effect to the second key concept.

I think that it is relatively easy to understand the implications of these provisions in the context of a conventional production unitization, but the implications are much more far reaching in a unit that comprises both sequestration and production interests. For example, it seems to entail that production leases will be continued even though the only activities occurring in the unitized zone are sequestration activities. If there were any doubt about this, cl 303 contains a long list of Crown production interests that are expressly deemed to be continued by the unitization:

For clarity, during the term of this Agreement, as of the Effective Date:

- (a) a lease under the Petroleum and Natural Gas Tenure Regulation (A.R. 263/1997) is deemed to be continued;
- (b) a primary lease under the Oil Sands Tenure Regulation (A.R. 92/2020) (OSTR) is deemed to be a continued lease designated as producing;
- (c) a continued lease under the OSTR is deemed to be designated as producing;
- (d) a rock-hosted minerals lease in its primary term or intermediate term under the Metallic and Industrial Minerals Tenure Regulation (A.R. 265/2022) (MIMTR) is deemed to be continued;
- (e) a brine-hosted minerals lease in its initial term under the MIMTR is deemed to be continued.

Article IV deals with the authority to conduct operations without regard to tract boundaries. In the GSUA this takes the form of a grant of authority from the royalty owners to the working interest owners. In the PSUA it seems to take the form of a grant of authority by all the parties to the agreement to the authorized representative. The PSUA defines this person as the “Working Interest Owner who holds a pore space tenure agreement issued under the *MMA* with respect to the Unitized Zone, and who is designated as the primary contact under this Agreement for the Parties other than the Crown.” (at cl 101(a)). This takes us back to the chicken and egg problem referenced above, but it also suggests again that the real purpose of the PSUA is not the unitization of different pore space lease tracts, but the unitization or reconciliation of pore space sequestration rights with other pore space interests however defined. For me this confirms that the question of how to combine such heterogenous working interests within a tract participation formula will be exceptionally challenging and may stretch the concept of a working interest to the breaking point: see *IFP Technologies (Canada) Inc v EnCana Midstream and Marketing*, [2017 ABCA 157 \(CanLII\)](#) (leave to appeal [dismissed](#)) and my post [here](#).

Article V prescribes that a tract can be qualified for conclusion “when *the* owner of one hundred percent (100%) of the Working Interest therein has become a Party.” (at cl 502, emphasis added). Once again this makes perfect sense in the context of homogenous production interests, but what does it mean when there are heterogenous production and sequestration interests within the same area? Who is *the* owner?

Article VI recites that the tract participation factors are recorded in Exhibit A (as above) and Article VII deals with such things as warranties as to title, while Article VIII, as already noted, deals with the transfer of interests.

Article IX, entitled “In general”, deals with some miscellaneous matters, two of which merit further comment. First, there is what looks to be a fairly obvious glitch in the last sentence of the force majeure clause, which currently reads as follows: “Substances shall terminate by reason of suspension of operations for any cause set forth in this clause.” (at cl 904). Or, if it is not a glitch, what on earth does the sentence mean?

The other clause that deserves notice is the compliance with laws clause, which provides that:

In exercising their respective rights and discharging their respective obligations under this Agreement, the Parties shall comply in all material respects with the provisions of the Regulations. In the event of any conflict between the provisions of this Agreement and the provisions of any of the Regulations, the latter provision shall prevail. (at cl 908)

And, as with the pore space lease and other similar Crown agreements, “Regulations” is defined in ambulatory terms to mean:

... all statutes, regulations, rules, orders and directives from time to time in force and effect in the Province of Alberta that relate, apply to or affect unit agreements or sequestration as defined in the MMA, conducted in Alberta, or unit agreements or storage agreements entered into in Alberta or that relate, apply to or affect any of the Unit Operations conducted pursuant to this Agreement. (at cl 101(i))

Articles X and XI deal with different aspects of the duration of the PSUA: Article X deals with the effective date of the agreement, while Article XI deals with termination. Clause 1102(1) contemplates that the PSUA terminates in one of three ways:

(1) Subject to clause 1001 [the effective date], this Agreement terminates:

(a) ninety (90) days after:

- i. all wells or facilities for the conduct of Unit Operations in the Unit Area have been abandoned, plugged or disposed of, or
- ii. receipt of written notification from the Unit Operator, whichever is the first to occur, or

(b) with ninety (90) days notice, if, in the opinion of the Minister, no Unit Operations have commenced within twelve (12) consecutive months after the Effective Date of this Agreement, or

(c) with ninety (90) days notice, if, in the opinion of the Minister, no injection activity for the purposes of Unit Operations have been conducted for a period of twelve (12) consecutive months.

One has to wonder whether these discretionary termination provisions are really suitable for sequestration operations especially given the need for ongoing monitoring, measurement, and verification (MMV) activities and the fact that (as noted in the section of this post on the PSL) termination of the PSUA will automatically bring the pore space lease to an end.

Conclusions

Oil and gas lawyers are very familiar with the concept of unitization and, perhaps to a lesser extent, with gas storage agreements. Such agreements seek to combine ownership interests in the same substances and to pursue one set of discretely defined activities such as production *or* storage. The PSUA seems to me to be considerably more ambitious. I say “seems to be” since one has to infer the purpose of the agreement from its technical text and the very limited guidance offered by the Application Guidelines. But if the intention of the PSUA really is to combine ownership rights pertaining to different substances and different activities, then I for one would like to see a lot more guidance from the drafters as to how they anticipate this working in practice.

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