

Guide for Offsets

Receiving and responding to offset notices and fulfilling obligations to offset production of a freehold well.

Overview

Offset obligations are a regular part of the oil and gas business in Alberta. An offset obligation exists any time a producing freehold well potentially could be draining an adjacent PNG Crown mineral agreement where there is no offsetting producing Crown well in the same zone. At any point from the issuance of a PNG Crown mineral agreement through to the agreement's expiry, an offset obligation may exist. In situations where a freehold well potentially may be draining Crown rights, an offset notice may be served to the adjacent Crown lessee(s).

Note:

All offset business is conducted through the [Electronic Transfer System](#) (ETS). Further information can be found through the ETS offset training modules.

Offset Notices Served

When a freehold well commences production of petroleum or natural gas, a notice may be served to the Crown lessee at any time during the term of the agreement. To satisfy the offset notice, the Crown lessee or authorized applicant must respond to the notice within six months.

Multiple offset notices may be served if one or more freehold well(s) produce from one or multiple zones and/or when multiple Crown PNG agreements exist.

Each offset notice is a specific, separate obligation that requires its own response. However, a single Crown well placed on production from multiple zones may satisfy multiple offset notices.

For example:

- If two offset notices are served on two different zones, a single well that is producing both zones may satisfy the notice. Conversely, two wells may be required if each produces a single offset zones.
- If two offset notices are served on the same land and zone, a single Crown producing well is required.

Requirements to Satisfy the Offset Notice

A Crown lessee or authorized applicant may satisfy an offset notice by completing any of the following:

- Provide data establishing that a Crown well is producing from the offset zone.
- Defer the obligation to produce by electing to pay offset compensation.
- Elect to surrender the rights down to the base of the offset zone, except:
 - zones that have a producing well,
 - are subject to a unit, or
 - a gas storage unit agreement.
- Demonstrate non-drainage.

Note:

A technical review is undertaken based on the information supplied within the application; therefore, any relevant geological, geophysical and engineering data (e.g., net pay mapping, cross-sections, seismic, production history) is required to support the offset notice response.

Drilling a well in a different spacing unit than where the notice was served does not prevent drainage

from occurring; therefore, the offset notice will not be satisfied.

Failure to Respond to an Offset Notice

Failure to respond to an offset notice may result in cancellation of the Crown agreement to the base of the offset zone. Exceptions to this cancellation rule include where there are zone(s) that have a producing well, are subject to either a unit or a gas storage unit agreement. In the absence of any of these exceptions, the Crown mineral agreement may be cancelled in its entirety.

Extensions

If there are extenuating circumstances that prevent a Crown lessee from responding to an offset notice within the six-month notice period, an application to extend the notice period can be made. The application must include compelling reasons as to why the original time frame is not sufficient.

Extensions are discretionary and are generally granted for circumstances beyond the lessee's control. They are not generally granted for economic or business decisions to not drill a well.

Well on Production

Alberta Energy must be notified when a well is placed on production from the offset zone. It is important to notify Alberta Energy quickly as the obligation to pay offset compensation remains in place until notification is received. As such, payors remain obligated to pay offset compensation prior to the date Alberta Energy is notified.

Once Alberta Energy confirms the well's production, the obligation to pay offset compensation ceases the first of the month in which the election response was submitted.

If an election to pay offset compensation is submitted, and a well is placed on production before

the obligation to pay offset compensation begins, the liability to pay offset compensation depends upon the expiry of the offset notice and when Alberta Energy was notified.

For example:

If a notice expires March 2nd and an election to pay offset compensation was made, the obligation to pay offset compensation begins April 1. If a well is placed on production from the offset zone in March and Alberta Energy is notified during March, no compensation is payable because the obligation does not begin until the first of the month following the notice expiry (April 1st). However, if Alberta Energy is not notified until sometime in May, the obligation for offset compensation remains in place for April.

Paying Offset Compensation

Electing to pay offset compensation defers the obligation to drill on the Crown agreement. Once an election to pay offset compensation is made, the obligation begins on the first of the month following the notice expiry.

Each month the freehold well produces, offset compensation is billed. Compensation is based on the amount of royalty that would be payable from the freehold well had that well been producing from Crown agreement.

Offset compensation is calculated two months following the production month and the monthly Statement of Account is issued to the payor through ETS.

For example:

June production data is available on Petrinex in August; therefore, June compensation owing is reflected on the Statement of Account issued in September.

Billing adjustments for prior production periods will be issued as an amendment on the next Statement of Account.

Calculation of Offset Compensation

The calculation of offset compensation is based on the freehold well that generated the offset notice. Therefore, offset compensation is calculated for each well separately and billed accordingly.

The value of the Crown's royalty share is calculated using 80% of the Gas Reference price or 100% of the Oil Par price. Refer to section 23 of the [PNG Tenure Regulation](#) for more information.

Offset compensation is calculated on the basis of a drilling spacing unit (DSU). Mineral agreements that cover the complete DSU are responsible for 100% of the offset compensation. If the subject agreement does not cover the complete DSU, compensation is prorated.

For example:

Generally, gas spacing is one section. If a quarter-section agreement is served a gas offset, only one-fourth of the offset compensation is payable.

Ending a Pay Election

A pay election may end when:

- a Crown well is placed on production and it is determined to be producing from the offset zone,
- the mineral rights subject to the offset notice are surrendered,
- evidence demonstrates that drainage from the freehold well is not occurring,
- the freehold well has, for a period of at least six consecutive months, ceased to produce petroleum or natural gas and the offset zone is no longer productive, or
- the freehold well, according to the Alberta Energy Regulator's records, is abandoned in its entirety or in the offset zone.

Alberta Energy reviews, verifies and approves all election changes to end paying compensation.

When approved, the pay end date is set to the first of the month in which the request was received. The payor will not be reimbursed for billing periods prior to the notification date.

Statements of Account for the production month(s) leading up to the pay end date may continue to be issued for up to three months following the election change.

Surrender Offset Notice

An election to surrender mineral rights or Crown agreement will end the requirement to pay offset compensation. Any producing shallow zones or zones that are subject to unit or a gas storage unit agreement remain in the agreement. The Crown lessee also retains all rights below the base of the offset zone.

Note:

Crown agreement surrenders can be submitted in ETS through the Agreement Management Surrender process or as an Offset response. Do not submit the surrender request to both business units.

Request for Review

If a request for review of the offset notice is made, it must include data (geological, geophysical or engineering) which evidences that the freehold well is not draining the Crown's reserves or that the offset zone does not fall within the Crown section.

A request for review must contain an alternate election to either pay offset compensation or surrender the affected rights. If Alberta Energy agrees with the lessee's interpretation, the notice will be withdrawn and the requirement to pay offset compensation will cease effective the submission date of the request.

If Alberta Energy's review determines that the Crown's reserves are being drained, the alternative election will be processed.

Reinstatement

If a Crown mineral agreement is cancelled or rights are deleted due to default or surrender, an application for reinstatement can be made. As prescribed under section 8(1)(e) of the [Mines and Minerals Act](#), application must be made within 60 days from the date of the agreement cancellation letter.

A request for reinstatement must include compelling reasons or the contributing factors that led to the deletion, surrender or cancellation of mineral rights. Reinstatement applications are submitted through ETS and payment of \$5,000.00, plus any other outstanding amounts (e.g., annual rental, offset compensation or interest) must be received before the reinstatement request can be approved.

Withdrawal of an Offset Notice Served

An offset notice can be withdrawn, in whole or in part, if:

- the freehold well is not draining the Crown,
- the offsetting zone is not contained within the adjacent Crown DSU, or
- the freehold well spacing changes and the Crown DSU is no longer adjacent to the freehold DSU.

Alberta Energy reviews all geologic, geophysical, and engineering data submitted with a request for review application. If the Crown agrees drainage is not occurring, the notice is withdrawn.

In those instances where the technical data does not support non-drainage, the notice remains in effect and the alternate election indicated in the request for review application is applied.

Withdrawing a notice does not preclude serving a notice in the future.

Useful Links:

Offset Response Form and Authorizations Available through [ETS](#).

ETS – Offset Online Learning

[Online learning course](#) is available to assist you in making this application through ETS.

ETS – Apply for Access

An ETS account is required in order to do an e-submission CMA application.

To [apply](#) for an ETS account setup to do business electronically with Alberta Energy, please contact Crown Land Data at phone (780) 644-2300 or email CrownLandDataSupport@gov.ab.ca

For reference, please go to Online Learning [portal](#) under Accounts (ETS) Administration tab and view [ETS Account Setup and Preferences](#) module.