



New North Resources Ltd.

Section 39 Review of
Common Carrier Order No. Misc. 2009-027
Knopcik Field

February 23, 2010

ENERGY RESOURCES CONSERVATION BOARD

Decision 2010-010: New North Resources Ltd., Section 39 Review of Common
Carrier Order No. Misc. 2009-027, Knopcik Field

February 23, 2010

Published by

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ENERGY RESOURCES CONSERVATION BOARD

Calgary Alberta

**NEW NORTH RESOURCES LTD.
SECTION 39 REVIEW OF
COMMON CARRIER ORDER NO. MISC. 2009-027
KNOPCIK FIELD**

**Decision 2010-010
Application No. 1621054**

DECISION

The Energy Resources Conservation Board has considered the findings and recommendation set out in the following examiner report, adopts the recommendation, and directs that Clause 3 of Common Carrier Order No. Misc. 2009-27 be amended as recommended in the examiner report.

Dated in Calgary, Alberta, on February 22, 2010.

ENERGY RESOURCES CONSERVATION BOARD

<original signed by>

B. T. McManus, Q.C.
Acting Chairman

ENERGY RESOURCES CONSERVATION BOARD

Calgary Alberta

**EXAMINER REPORT RESPECTING
NEW NORTH RESOURCES LTD.
SECTION 39 REVIEW OF
COMMON CARRIER ORDER NO. MISC. 2009-027
KNOPCIK FIELD**

**Decision 2010-010
Application No. 1621054**

1 RECOMMENDATION

Having considered all the evidence, the Energy Resources Conservation Board (ERCB/Board) examiners recommend that Clause 3 of Common Carrier Order No. Misc. 2009-027 be amended as follows:

“For the period commencing March 20, 2008, and ending December 31, 2010, and in each calendar year thereafter, gas production from the Knopcik Halfway JJ Pool must be distributed between the wells with unique identifiers 00/14-09-074-11W6/0 and 00/03-16-074-11W6/0 in the proportion of 66 and 34 per cent respectively. If gas production is not balanced at the end of a balancing period, the overproduced well must be shut in until the underproduced well has produced its proportionate share specified in this clause. The subsequent balancing periods will commence once the production has been balanced and be administered annually thereafter from the date the overproduction was retired.”

2 BACKGROUND

New North Resources Ltd. (New North) and TykeWest Limited (TykeWest) jointly acquired a well located at Legal Subdivision (LSD) 14, Section 9, Township 74, Range 11, West of the 6th Meridian (the 14-9 well). Production from the well is transported by a pipeline operated by New North to a blending facility located at LSD 13-15-74-11W6M and into EnCana Corporation’s (EnCana’s) gathering system. The blending facility is required to dilute the sour gas with sweet gas to a hydrogen sulphide (H₂S) concentration that meets the H₂S limit of EnCana’s gathering system. TykeWest subsequently drilled a well at LSD 3-16-74-11W6M (the 3-16 well), which is in the same pool as the 14-9 well. New North does not have an interest in the 3-16 well. Although the 3-16 well is capable of production, it has not been tied into a gathering system. There is a contractual dispute between New North and TykeWest regarding the 14-9 well and the associated facilities, which is the subject of civil litigation. As TykeWest was unable to make reasonable arrangements to use the pipeline operated by New North, TykeWest filed Application No. 1552791 with the ERCB seeking a common carrier order to have New North transport TykeWest’s gas to market.

On February 10, 2009, the Board issued *Decision 2009-013: TykeWest Limited, Application for a Common Carrier Order, Knopcik Field*, and on March 18, 2009, Common Carrier Order No. Misc. 2009-27 was issued, which declared New North to be a common carrier of gas produced from the Knopcik Halfway JJ Pool (JJ Pool) through the pipeline extending from LSD 3-16-74-11W6M to LSD 13-15-74-11W6M, including the H₂S analyzer and blending facility at LSD 13-15-74-11W6M. Clause 3 of the order specified that for the period commencing March 20, 2008,

and ending December 31, 2009, and in each calendar year thereafter, gas production from the JJ Pool must be distributed between the 14-9 and 3-16 wells in the proportion of 66 and 34 per cent respectively.

On March 20, 2009, New North applied for a review of the order under Section 39 of the *Energy Resources Conservation Act*. Specifically, New North requested a revision of Clause 3 of the order, such that the date upon which the initial balancing had to be accomplished should be extended from December 31, 2009, to the first anniversary of the date upon which the 3-16 well was tied into the facilities. New North submitted that since the 3-16 well had not yet been tied in, it would be difficult to achieve the initial balancing by December 31, 2009, and at some point balancing would become physically impossible to achieve.

TykeWest argued that New North had not met the test required for the Board to grant a review and hence the application should be denied.

On July 23, 2009, the Board granted New North's request for a review on the basis that the 3-16 well not being tied in was a change in circumstance that could lead the Board to vary Clause 3 of the order. The review was limited to a written hearing of the initial period of time required to balance production between the wells in the allocated proportions and the accounting period thereafter.

3 HEARING

On October 16, 2009, the Board issued a notice of hearing. The review hearing was conducted through a written process by Board-appointed examiners G. W. Dilay, P.Eng. (Presiding Member), C. A. Crowfoot, and J. R. MacGillivray, P.Geol. The written hearing closed on December 11, 2009. Those who participated in the hearing are listed in Appendix 1.

4 ISSUE

Considering that Clause 3 of the order requires the initial balancing to be completed by December 31, 2009, and this date has passed without the initial balancing being done, an amendment to the clause is needed. The examiners consider the issue respecting the application to be the manner in which Clause 3 should be amended.

In reaching the determinations contained within this report, the examiners have considered all relevant materials constituting the record of this hearing. Accordingly, references in this report to specific parts of the record are intended to assist the reader in understanding the examiners' reasoning relating to a particular matter and should not be taken as an indication that the examiners did not consider all relevant portions of the record with respect to that matter.

5 VIEWS OF NEW NORTH

New North submitted that Clause 3 should be amended such that

- the tie-in of the 3-16 well, defined by the well being ready for commercial service and the first receipt of production into the facilities, should be used as a triggering event for the commencement of the initial balancing period; and
- the time period to accomplish the initial balancing following the triggering event should be one year from the tie-in date.

If the Board wanted to have balancing occur thereafter on a calendar-year basis, New North had no issue with a stub period from such date until December 31 in that year.

New North submitted that using the tie-in date as the triggering event was the only logical choice, since that was the first date on which gas produced from the 3-16 well could physically flow. New North agreed that the on-production date for the 3-16 well would be an appropriate proxy for the tie-in date. New North stated that its understanding was that a one-year period to conduct balancing was typical or normal and it saw no reason to vary from the normal practice. It also stated that a relatively long period may be required to achieve the initial balancing, considering the practical capacity limitations affecting the blending facility.

New North estimated the remaining recoverable gas reserves for the JJ Pool to be 67.8 million cubic metres (10^6 m^3) and submitted that these reserves were sufficient for TykeWest to recover its share once the 3-16 well was tied in.

Although New North voluntarily shut in the 14-9 well on March 18, 2009, the well was put back on production on September 29, 2009, to produce gas for the winter. New North strongly opposed any order requiring the shut-in of the 14-9 well pending the tie-in of the 3-16 well. New North submitted that it required cash flow from the well and needed to establish a current production history to pursue the acquisition of additional fuel gas for blending. In addition, New North submitted that revenue from the 14-9 well was its only means to recover monies owed by TykeWest for past production, gathering, and blending facility costs. New North believed it would be inappropriate for the Board to shut in the 14-9 well, since New North had not been the cause of the tie-in delay, it had acted proactively in connection with the tie-in, and it had been reasonable in its contractual requirements for the tie-in.

New North questioned whether the ERCB had jurisdiction to shut in production from the 14-9 well in the context of a common carrier order. It believed that although the ERCB had jurisdiction within the common carrier legislation to direct the proportion of production from wells offering production, equity issues within a pool were addressed in the context of a rateable take application. New North noted that TykeWest had not applied for a rateable take order and believed such an application would be premature, since the 3-16 well was not tied in. New North believed that the imposition of a common carrier obligation ought to lie as lightly as possible and that an owner's right to produce its share of the resource from the JJ Pool should not be paramount over the common carrier's right to protect itself and its joint owners from commercial risks that could arise from the obligation to carry third-party gas.

New North reviewed several ERCB decision reports regarding applications for rateable take, common carrier, and common processor orders to see if in those cases where no minimum rates were specified in the orders and one well was shut in, the decision reports stated that the other wells would be required to be shut in to maintain the allocation set out in the ERCB orders. New North stated that none of the decision reports expressly indicated that if no minimum rates were

set and one well was shut in, the other wells must be shut in to maintain the allocation in the order. It also stated that in the cases it reviewed, minimum rates had been promoted or accepted by the parties. New North noted that at the hearing that led to *Decision 2009-013*, it had not requested a minimum rate due to the increased cost of producing the 14-9 well at lower production rates.

With respect to TykeWest's argument that Section 7 of the *Oil and Gas Conservation Act (OGCA)* provided jurisdiction for the Board to shut in the 14-9 well, New North submitted that the general powers referred to in Section 7 only applied when a remedy was not otherwise specifically authorized by the *OGCA*. New North argued that the rateable take provisions of the *OGCA* addressed the appropriate remedy available to address any inequity, so Section 7 would not be appropriate in this case.

6 VIEWS OF TYKEWEST

TykeWest submitted that Clause 3 should be amended as follows:

- The triggering event for commencement of the initial balancing period should be the tie-in date of the 3-16 well in the event that tie-in could be achieved in a reasonable timeframe.
- The 3-16 well should have a maximum period of six months following its tie-in to produce while the 14-9 remained shut in; thereafter, if additional balancing were required, both wells could produce subject to the 3-16 well achieving its initial balancing in three months.

Although TykeWest did not provide an alternative triggering event if tie-in of the 3-16 well could not be achieved in a reasonable timeframe, TykeWest stated that it supported a reasonable on-stream date as a proxy for the tie-in date.

TykeWest submitted that there were $63.8 \times 10^6 \text{ m}^3$ of gas reserves¹ remaining in the JJ Pool and estimated the reserve life to be about 7 years, which indicated that there were sufficient reserves to allow the 3-16 well to recover its share of the gas reserves. Although there were enough reserves, TykeWest submitted that it would be unfairly burdened by fixed costs when the JJ Pool started to decline. The longer production from the 3-16 well was delayed, the closer it would be to the start of the imminent decline of the pool and the higher the fixed costs would be. TykeWest stated that this was in addition to the substantial negative impact that a 2 ½-year shut-in period had had on the profitability of the 3-16 well for TykeWest.

TykeWest stated that it had attempted to negotiate terms for the tie-in of the 3-16 well in good faith but that New North had attempted to enforce unacceptable terms and conditions. TykeWest believed that there was no motivation for New North to come to reasonable terms for the tie-in of the 3-16 well if the 14-9 well remained on production. It viewed the shut-in of the 14-9 well as the only method by which equity in the pool could be preserved and submitted that the Board should order the shut-in of the 14-9 well until the 3-16 well was tied in and had produced its share of gas from the JJ Pool. TykeWest stated that as New North had voluntarily shut in the 14-

¹ TykeWest actually submitted that there were $63.8 \times 10^3 \text{ m}^3$ of gas reserves. The examiners assume that this should have been $63.8 \times 10^6 \text{ m}^3$.

9 well for a period of 5 ½ months between March 18, 2009, and September 29, 2009, it did not foresee any hardship to New North from an additional shut-in period.

TykeWest responded “yes” to the question of whether the absence of a minimum rate in a common carrier order meant that if one well were shut in, the other wells subject to the common carrier order would also have to be shut in, but it did not provide any reasons for its response. TykeWest submitted that the general powers described in Section 7 of the *OGCA* gave the ERCB more than sufficient jurisdiction to shut in the 14-9 well.

7 FINDINGS OF THE EXAMINERS

The examiners agree that it is not known when the 3-16 well will be tied in. Although setting a triggering event followed by a time period to achieve the initial balancing is one way to deal with this unknown, the examiners are concerned about the uncertainty this creates about when the initial balancing will be achieved if the 14-9 well were to be produced while the 3-16 well is not tied in. Because of this concern, the examiners considered two options for how Clause 3 should be amended:

- Option 1 – set a triggering event followed by a time period to achieve the initial balancing, but with the condition that the 14-9 well must be shut in from the date of the amended order until the 3-16 well is tied in (the condition).
- Option 2 – set a fixed date for the initial balancing to be achieved.

With respect to Option 1, the examiners consider the tie-in of the 3-16 well, represented by its on-production date, to be the most logical triggering event. In regard to how long it would take to achieve the initial balancing following the triggering event, the examiners estimate that it would take 5.4 to 7.4 months, based on the production that occurred from the 14-9 well from March 20, 2008, to October 31, 2009, production rates for the facility of 25 thousand cubic metres per day ($10^3 \text{ m}^3/\text{d}$) and $34.2 \times 10^3 \text{ m}^3/\text{d}$ (which were submitted by TykeWest and New North respectively), and the assumption that only the 3-16 well would be produced once it is tied in. If the 14-9 well was produced in November and December 2009, the examiners estimate the time to achieve the initial balancing would be increased to between 6.4 and 8.4 months. These estimates indicate to the examiners that a 9-month time period could be required for the initial balancing following the triggering event.

Since Option 1 includes a condition that the 14-9 well must be shut in from the date of the amended order until the 3-16 well is tied in, the examiners considered several different approaches that could be used as the basis for setting this condition.

One approach considered was whether depletion of the gas pool could be used as a reasonable basis. The examiners note that both New North and TykeWest agreed that there were enough remaining gas reserves to allow for the initial balancing to be achieved for any reasonable time when the 3-16 well is tied in. Therefore, the examiners believe it would not be appropriate to require the 14-9 well to be shut in from the date of the amended order until the 3-16 well is tied in on the basis of the gas reserves being depleted.

A second approach considered was whether the absence of a minimum rate in the subject common carrier order could be used as a basis for the condition. The examiners note that the Board has used minimum rates specified in ERCB orders as a way to allow some wells to produce at the minimum rate if the production rate of another well falls below the minimum rate. While the examiners believe that if a minimum rate is not specified in an order, the intent is that all wells must be shut in if one well is shut in, the examiners acknowledge that, as pointed out by New North, previous ERCB decisions do not explicitly state this.

Furthermore, in this case, the examiners believe there are two other reasons why the absence of a minimum rate in the subject common carrier order should not be used as the basis for setting the condition. The first is that the examiners view this case to be unique in that the reason for the 3-16 well not being on production is not any operational problems with the well; rather it is a dispute between New North and TykeWest regarding the tie-in of the well to the common carrier pipeline. The examiners believe that operational problems and market conditions are the types of expected situations where wells subject to a common carrier order with no minimum rate specified would be shut in, unlike the circumstance in this case.

The second reason is that in this case, the examiners would not want to prevent one well from producing when the other well is not producing. As pointed out by New North, it did not request a minimum rate at the hearing that led to *Decision 2009-013* because of the increased cost of producing at lower production rates. The examiners would not want to remove the option for New North and TykeWest to produce only the 14-9 well for 66 per cent of the balancing period and to produce only the 3-16 well for 34 per cent of the balancing period. Such an option would allow the wells to be produced at higher production rates and hence lower operating costs.

Based on these considerations, the examiners believe that the absence of a minimum rate in the subject common carrier order is not a good basis on which to require the 14-9 well to be shut in from the date of the amended order until the 3-16 well is tied in.

A third approach considered was TykeWest's submission that Section 7 of the *OCGA* provides sufficient jurisdiction for the Board to require the shut-in of the 14-9 well. Section 7 states:

The Board, with the approval of the Lieutenant Governor in Council, may make any just and reasonable orders and directions the Board considers necessary to effect the purposes of this Act and that are not otherwise specifically authorized by this Act.

The examiners believe this situation is not significant enough to warrant the Board to request an approval from the Lieutenant Governor in Council to require the 14-9 well to be shut in from the date of the amended order until the 3-16 well is tied in.

Based on the considerations described above, the examiners do not believe there is a very good basis for the Board to require the 14-9 well to be shut in from the date of the amended order until the 3-16 well is tied in. This leaves Option 2, which is to set a fixed date for the initial balancing to be achieved. Considering that it has been almost one year since the common carrier order was issued and no initial balancing has occurred, the examiners believe that the date to require initial balancing to be achieved should be relatively soon. A date of December 31, 2010, is recommended.

The examiners are of the view that the amended order should include a provision to prevent the possibility of an ongoing problem with balancing not being achieved. Section 44(a) of the *OGCA* states:

Where the Board or its authorized representative determines that a licensee, approval holder, contractor or operator of a well or facility has contravened or failed to comply with this Act, the regulations or an order of the Board [emphasis added], or that a method or practice employed at a well or facility or any equipment or installation at a well or facility is improper, hazardous, inadequate or defective,

- (a) the Board or its authorized representative may order the well or facility to be shut down or closed...

Therefore, the examiners recommend that Clause 3 include a provision that if balancing has not been achieved at the end of a balancing period, the overproduced well must be shut in until the underproduced well has produced its proportionate allocation. In such a situation, the overproduced well would be subject to enforcement under Section 44(a) of the *OGCA*.

The form of the proposed order is provided as Appendix 2.

Dated in Calgary, Alberta, on February 22, 2010.

ENERGY RESOURCES CONSERVATION BOARD

<original signed by>

G. W. Dilay, P.Eng.
Presiding Member

<original signed by>

C. A. Crowfoot
Examiner

<original signed by>

J. R. MacGillivray, P.Geol.
Examiner

APPENDIX 1 HEARING PARTICIPANTS

Principals and Representatives
(Abbreviations used in report)

New North Resources Ltd. (New North)
D. C. Edie, Q.C.

TykeWest Limited (TykeWest)
T. Tycholis, P.Eng.

Energy Resources Conservation Board staff
B. Kapel Holden, Board Counsel
K. Fisher
J. Rempel

APPENDIX 2 FORM OF ORDER



Common Carrier Order No. Misc 2009-27A

MADE at the City of Calgary, in the Province of Alberta, on	ENERGY RESOURCES CONSERVATION BOARD
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FORM OF ORDER*

WHEREAS the Lieutenant Governor in Council, by Order in Council numbered O.C. 111/2009 and dated March 11, 2009, authorized the granting of Common Carrier Order No. Misc. 2009-27;

WHEREAS the Energy Resources Conservation Board is prepared to approve an amendment to the order.

The Energy Resources Conservation Board, pursuant to the Oil and Gas Conservation Act, chapter O-6 of the Revised Statutes of Alberta, 2000, orders as follows:

- 1) Board Order No. Misc. 2009-27, an order respecting a common carrier declaration in the Knopcik Field, is amended.
- 2) Clause 3 is struck out and the following clause is substituted:
- 3) For the period commencing March 20, 2008, and ending December 31, 2010, and in each calendar year thereafter, gas production from the Knopcik Halfway JJ Pool must be distributed between the wells with unique identifiers 00/14-09-074-11W6/0 and 00/03-16-074-11W6/0 in the proportion of 66 and 34 per cent respectively. If gas production is not balanced at the end of a balancing period, the overproduced well must be shut in until the underproduced well has produced its proportionate share specified in this clause. The subsequent balancing periods will commence once the production has been balanced and be administered annually thereafter from the date the overproduction was retired

END OF DOCUMENT

* This is only a form of order. The order, when issued, may have minor variations from that set out here.