Alberta Energy Regulator

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By email only

March 26, 2024

Bennett Jones LLP

Attention: Daron Naffin

Rowbotham Law Office

Attention: David Rowbotham, Counsel

Dear Sirs:

RE: Request for Regulatory Appeal by Sinopec Daylight Energy Ltd.
Eclipse Resources Ltd.
Application Nos.: 32616957 & 32617209 (Applications)
Well Licence Nos.: 0511633 & 0511639
Locations: 00/12-05-050-05W5 (12-05 Well) and 00/13-05-050-05W5 (13-05 Well) from 15-04-050-05W5
Request for Regulatory Appeal No.: 1949530

The Alberta Energy Regulator (**AER**) has considered the request for regulatory appeal (**RRA**) submitted by Sinopec Daylight Energy Ltd. (**Sinopec**) made under section 38 of the *Responsible Energy Development Act* (**REDA**) in relation to the AER's decision to approve the Applications and issue well licence nos.: 0511633 and 0511639 (**Well Licences**) to Eclipse Resources Ltd. (**Eclipse**) on November 22, 2023 (**Decision**). The AER has reviewed Sinopec's submissions and the submissions made by Eclipse.

For the reasons that follow, the AER has decided to dismiss Sinopec's request for regulatory appeal under section 39(4)(c) of the REDA as it is not properly before it.

Section 39(4) of REDA provides that:

> 39(4) The Regulator may dismiss all or part of a request for regulatory appeal
>
> (a) if the Regulator considers the request to be frivolous, vexatious or without merit,
>
> (b) if the request is in respect of a decision on an application and the eligible person did not file a statement of concern in respect of the application in accordance with the rules, or

(c) if for any other reason the Regulator considers that the request for regulatory appeal is not properly before it.

Parties' Submissions

Sinopec's Request

In its December 15, 2023, request for regulatory appeal Sinopec seeks a regulatory appeal on the basis that the Eclipse Well Licences are in direct conflict with the *Oil and Gas Conservation Rules* (**OGCR**) sections 1.020(1)(4) and 4.021, which outline the requirements for common ownership and specify that no well shall be produced unless there is common ownership throughout the applicable drilling spacing units (**DSUs**). Sinopec submitted that Eclipse has not obtained common ownership across the multiple DSUs associated with the two horizontals wells, by way of an executed pooling agreement or other arrangement in view of the different lessee ownership, and that to Sinopec's knowledge, the AER was not aware of this at the time of issuing the Well Licences as per *Directive 056: Energy Development Applications and Schedules* (**Directive 056**).

Sinopec submits that Eclipse and Morichal Energy Corp. (Morichal) hold registered working interests of 50% each in the NW ¼ of section 04-050-05W5M and a beneficiary working interest of 31.625% each. Sinopec holds a beneficial working interest of 36.75% in the Cardium Formation mineral rights in the ¼ section, which it says will be directly affected by the Decision, which allows Eclipse to drill and produce from the Cardium Formation where there is uncommon ownership across the multiple DSUs associated with the wells. The wells will also be traversing through the North ½ of Section 05-050-05W5 where Eclipse and Morichal have registered and beneficial working interests. Sinopec requested that the AER conduct a *Directive 056* mineral rights audit of Eclipse's Applications to substantiate the uncommon ownership and cancel the Well Licences.

Eclipse Response

Eclipse initially responded on December 18, 2023, disputing Sinopec's allegations, and noted that sections 16 and 18 of the *Oil and Gas Conservation Act* (**OGCA**) apply in the circumstances. Eclipse noted that Section 16(2) provides that upon 30 days' notice to the licence holder, the licence holder is entitled to prove entitlement to a licence to the AER, if the AER has doubt in that regard.

Eclipse's substantive response submissions reiterated its initial position regarding sections 16 and 18 of the OGCA and suggested that, until the requirements of section 16(2) are met, Eclipse's view is that the Licences cannot be cancelled or suspended. Eclipse further submits that the Licences are an "appealable

decision" within the meaning of section 36(a)(iv) of REDA, subject to compliance with the requirements of section 16 of the OGCA.

Eclipse submits that Sinopec's request is without merit, no statements of concern were registered with the AER because they were received after the licences were issued and the request is not properly before the AER given the provisions of sections 16 and 18 of the OGCA. It asks that the AER dismiss the request.

Eclipse further submits that to understand why Sinopec's request is without merit, the fact and circumstances that gave rise to Eclipse's application for the licences must be understood. Eclipse and Morichal are the majority working interest owners in the NW ¼ of Section 04-50-05-W5M (referred to as the joint lands) as a result of leasing out 100% of the Crown's petroleum and natural gas rights in the NW ¼ . Eclipse and Morichal each hold a 50% working interest in the mineral rights. Subsequently, Eclipse and Morichal entered into a contractual arrangement, referred to as the Farmin Agreement, with Sinopec, under which Eclipse and Morichal farmed out 18.75% of their working interests in the petroleum and natural gas rights in the Cardium Formation to Sinopec. The resulting working interests in the joint lands equal a working interest of 36.75% for Sinopec, and 31.625% for each of Eclipse and Morichal.

Eclipse submits that on November of 2023, under the Farmin Agreement, it issued an Independent Operation Notice (**ION**) to Sinopec and Morichal for the drilling of the 13-05 well through the joint lands (**13-05 ION**), specifically through the one DSU in which Sinopec has an interest. Eclipse's ION also notes that, in addition to drilling through the joint lands, the 13-05 well will also be drilled through the adjacent Eclipse/Morichal Lands, which are comprised of two DSUs in which Sinopec has no interest. Eclipse notes that the first two paragraphs of the "Special Provisions" section of the 13-05 ION makes reference to section 7.2.4 of *Directive 065: Resources Applications for Oil and Gas Reservoirs* (**Directive 065**) as follows:

> *7.2.4 The productive part of a horizontal wellbore in each DSU is considered a wellbore for the purpose of section 4.021 of the OGCR. The productive part of a wellbore is the portion open to the producing zone or formation/pool.*
>
> *The portion of the 13-05 Well that is drilled across the Joint Lands is therefore a separate well for all purposes of Article 10 of the JOA. The portions of the 13-05 Well that are drilled across the two (2) drilling spacing units that comprise the Eclipse/Morichal lands are separate wells that are not part of the Proposed Operation and the cost these separate wells will be borne by Eclipse and Morichal jointly.*

Eclipse also notes that Clause 1020 of the JOA, which is attached to the Farmin Agreement binds Eclipse Eclipse, Morichal and Sinopec (as the successor to West Energy Ltd.). Clause 1020 states:

> *Clause 1020 of the JOA provides that if an independent operation is the drilling of a well to which the forfeiture in Clause 1010 does not apply, the participating parties may include the well and its spacing unit in a pooling agreement or unit with the consent of the non-participating parties, which consent shall be unreasonably withheld. A unit agreement ("Unit Agreement") will be prepared by Eclipse and forwarded to Sinopec and Morichal for signature or consent, as applicable, at the earliest opportunity. The Unit Agreement will consist of the Join Lands and the Eclipse/Morichal Lands and will provide that all costs of the 13-05 Well and the production therefrom will be allocated to each of the three drilling spacing units included in the unit on a surface area basis. It is the position of Eclipse that in all circumstances, the unitization will be equitable, reasonable and completely consistent with good oilfield practice.*

Eclipse received email correspondence from Sinopec on November 27, 2023, indicating that Sinopec had taken the position that it would not respond to the 13-05 ION as the 13-05 Well would be drilled through lands not part of the JOA; that the 13-05 Well requires common ownership across the three DSUs that the well would cross; that Clause 1020 of the JOA was not applicable in this case; that Sinopec has no contractual obligation to discuss, or enter into a pooling agreement, etc., with Eclipse in respect of the 13-04 Well; that there is no mechanism in Alberta Law, regulations, or the JOA to compel Sinopec to participate in or make a decision on the 13-05 Well; and, that *Directive 065* specifies that no well shall be produced unless there is common ownership throughout the DSUs.

In response to Sinopec's email, Eclipse submits that the 13-05 ION is restricted to the portion of the 13-05 Well to be drilled through the Joint lands. It submits that Sinopec's position that the 13-05 Well requires common ownership across the three DSU's through which the well will be drilled, is incorrect as section 7.2.4 of *Directive 065* is quite clear that the productive part of a horizontal wellbore in each DSU is considered a separate well and notes that the common ownership issue is dealt with by virtue of the application of Clause 1020 of the JOA.

With respect to Sinopec's interpretation of Clause 1020 of the JOA that its application in this case does not apply to a pooling involving multiple spacing units that include lands other than the joint lands, Eclipse notes that this interpretation is unduly narrow and is not supported by the clear and plain meaning of Clause 1020. With respect to Sinopec's position that there is no contractual obligation to discuss or enter into a pooling or unit agreement with Eclipse for the 13-04 Well, Eclipse submits this is untrue as Sinopec is contractually bound by the provisions of the JOA. Eclipse added that there is a mechanism under the JOA to compel Sinopec to make a participation decision with respect to the 13-05 ION, as there are provisions of the JOA that apply in this case. In later correspondence Eclipse noted that the requirement for "common ownership" as such term is defined in section 1.020(2)-4(b) of the OGCR, is satisfied because the working

interest ownership is the same throughout each of the DSU's through which the 13-05 and the 12-05 wells will be drilled. Furthermore in its response, Eclipse notes that the Licenses are in compliance with section 4.021(2) of the OGCR and are not in conflict with *Directive 065*, particularly having regard to the fact that Eclipse is not applying for a "bloc", "project" or "holding" (as such terms are defined in the OGCA) and that the provisions of Part 7 of *Directive 065*, which relate to applications for special well spacing, do not apply in this case.

Eclipse submitted that on November 27, 2023, Morichal issued an ION to Sinopec and Eclipse for the drilling of the 12-05 Well (**12-05 ION**), and that the 12-05 ION contains the same provisions as the 13-05 ION but relates to the 12-05 Well. Eclipse submitted that Sinopec responded to the 12-05 ION, later that same day, November 27, and reiterated the same position as it had taken in respect of the 13-05 ION.

Eclipse notes that as the 13-05 ION and 12-05 ION relate to drilling of wells through the joint lands, Sinopec's refusal to respond to the IONs should be deemed as Sinopec having elected to not participate in the drilling of the wells. Eclipse submits that Eclipse and Morichal have offered Sinopec the opportunity to participate in the development of both the joint lands and the Eclipse/Morichal lands on an equitable basis because that is the most efficient and economical way to proceed with the development, and because it minimizes the impact on the environment. Eclipse's submission concluded that:

> The joint lands and the Eclipse/Morichal lands are owned by the Province of Alberta for the benefit of the people of Alberta and are leased to Eclipse and/or Morichal for the development of oil and gas resources within, upon and under the joint lands and the Eclipse/Morichal lands for the benefit to the people of Alberta. Eclipse, Morichal and Sinopec have an obligation to maximize the economic return from these resources and to minimize the environmental impact of the development of these resources for the benefit of the people of Alberta. Sinopec's position that it will not entertain pooling the Joint Lands with the Eclipse/Morichal Lands is contrary to the best interests of the people of Alberta and is contrary to the stated objectives set forth in section 4(c) of the OGCA…

Sinopec's Reply

Sinopec replies on January 25, 2024 that the Decision was made under the OGCA, an energy resource enactment, without a hearing, and therefore, the issuance of the Licences is an appealable decision within the meaning of section 36(a)(iv) of the REDA, and the issue of Eclipse's purported compliance with section 16 the OGCA does not affect this fact.

Sinopec's request for regulatory appeal was filed in accordance with the *Alberta Energy Rules of Practice*, despite Eclipse's suggestion that it should be dismissed because no SOCs were filed; Sinopec notes that it did file two SOCs with the AER on December 14, 2023, that were not registered by the AER, because

Sinopec was not able to file statements of concern ahead of the issuance of the Licences, because [the Well Licences] were issued on the same day that Eclipse submitted the Applications.

Sinopec submits Eclipse has provided no submissions suggesting that it is not an eligible person or that the request is not properly before the AER on this basis. Sinopec submitted that it is directly and adversely affected by the issuance of the Well Licences because Eclipse's drilling and production pursuant to the Well Licences will adversely impact Sinopec's mineral rights in the NW ¼ of Section 04-050-05W5 as it permits for the depletion of the oil reserves in the area.

Sinopec's request has merit and raises genuine issues that are clearly within the jurisdiction of the AER and that warrant the granting of a regulatory appeal. It notes that the AER has previously stated in a letter decision[1] that "[t]he determination whether an application should be dismissed as 'without merit' is a screening or gatekeeping function. This function should be used in very clear cases where this [sic] is no reasonable basis in the evidence for proceeding to the next stage which is the regulatory appeal".

Furthermore, Sinopec explains that the request raises concerns regarding Eclipse's failure to comply with the regulatory scheme and the resulting direct and adverse impact on Sinopec as a mineral rights holder in the DSU traversed by the proposed 12-05 and 13-05 Wells. Sinopec also submits that Eclipse's interpretation of the parties' commercial agreements do not undermine the legal merit of the request for regulatory appeal and relate to matters that are outside the jurisdiction of the AER.

Sinopec further submits that the Licences authorize activities that do not comply with section 4.021 of the OGCR, which states that "[n]o well shall be produced unless there is common ownership throughout the drilling spacing unit." This is because the working interest ownership differs across the multiple DSUs associated with the 12-05 and 13-05 Wells. Section 16 of the OGCA provides that no person may apply for or hold a well licence for the recovery of oil unless they are entitled to the right to produce the oil from the well.

Sinopec replies that in the absence of common mineral rights ownership across the relevant DSUs, there must be a pooling arrangement in place to allow the production of oil from the 12-05 and 13-05 Wells and, accordingly, to allow Eclipse to apply for and hold the Licences. Sinopec submits that it is clear that there is no valid and undisputed pooling arrangement in place that would support Eclipse's assertions as to the merit of the RRA, and that, "*the only aspect of the parties' contractual dispute that is relevant to the AER's determination of the RRA is the fact that Eclipse does not have an undisputed claim that there is a valid*

[1] AER Letter Decision re: Request for Regulatory Appeal No. 1865544, dated October 11, 2016.

unit agreement in place with respect to the proposed 12-05 and 13-05 Wells, as required by applicable regulations."

In response to Eclipse's assertions that its proposed operations are in the best interest of the Province of Alberta, Sinopec submits that this is a mischaracterization of the AER's mandate and the regulatory scheme in an improper attempt to further Eclipse's own commercial interests; and, that the AER is not an arbitrator of private contractual disputes, and that the OGCA and the REDA are not intended to be used to impose commercial agreements on industry participants without their consent.

Sinopec's reply submits that its request is properly before the AER as it raises valid concerns regarding Eclipse's entitlement to hold the Licences under section 16 of the OGCA. Sinopec submits that its request meets the requirements of section 38 of REDA, and an appeal should be granted as the issuance of the Licences has a direct and adverse effect on Sinopec's mineral rights in the NW ¼ of section 04-050-05W5, raises genuine issues with respect to this impact, as well as with Eclipse's failure to comply with the applicable regulatory scheme.

Sinopec's Compliance Request

After receiving a follow up inquiry from Sinopec on February 8, 2024, regarding its audit requested in the request, the AER's regulatory appeal coordinator responded on February 12, 2024, to Sinopec and Eclipse, advising that the AER's Audit group, conducted a *Directive 056* audit of the Applications, and the audit was found to be satisfactory, and no enforcement action was taken.

On February 15, 2024, the AER Resource Compliance received correspondence from Sinopec, indicating that, despite the satisfactory Directive 056 audit results, Sinopec continues to have serious concerns with Eclipse's entitlement to hold the Well Licences and requested that the AER require Eclipse to prove its entitlement to apply for and hold the Well Licences pursuant to section 16(2) of the OGCA. Sinopec submitted that Eclipse failed to comply with applicable legislative requirements and AER directives in applying for the Well Licences, notably by failing to identify Sinopec's outstanding concerns and working interest in relation to certain DSUs. Sinopec submitted that, "*Eclipse does not have valid or undisputed rights in place that would allow it to hold the Well Licences and produce from the relevant wells, and is not in compliance with applicable legislation and rules."* **(February 15 Request)**.

Eclipse responded to the February 15 Request submitting that, in its view, Sinopec's request that the AER asked Eclipse to prove its entitlement to the licences is consistent with the requirements in section 16 of the OGCA and is how Sinopec should have proceeded in the first place. Eclipse submitted that its response submissions of January 9, 2024 fully set out its position and that there is no basis to proceed with a

regulatory appeal nor is there now any basis to require Eclipse to prove its entitlement to the Well Licences. Eclipse reiterated its previous submissions noting that:

- the AER's audit concluded that the Applications were found to be satisfactory;
- the Applications were applied for, and the Well Licences were issued prior to Sinopec raising any concerns;
- the requirement of "common ownership"[2], is satisfied because the working interest ownership is the same throughout each of the DSUs through which each of the 12-05 Well and the 13-05 Well have been drilled by virtue of the unitization of all the DSUs in each case[3].
- The Well Licences are compliant with Section 4.021(2) of the OGCR and are not in conflict with AER Directive 065.

Eclipse concluded by submitting that it had recently completed the drilling of the 12-05 Well and 13-05 Well and that it would be proceeding with completion of both wells shortly, in compliance with best operating practices.

Reasons for Decision

This request for regulatory appeal involves the granting of two licences to Eclipse for horizontally drilled wells. The two wells in question, the 12-05 Well and the 13-05 Well traverse through the NW ¼ of Section 04-050-05W5M, where Sinopec has a 36.75% working interest in the mineral rights in the Cardium Formation as a result of the contractual arrangement with Eclipse and Morichal.

Sinopec seeks the regulatory appeal on the basis that Eclipse has not obtained common ownership through the multiple DSUs Eclipse's wells will be traversing. Sinopec submits there is no pooling arrangement between the parties and therefore the wells are not in compliance with sections 1.020(1)(4) and 4.021 of the OGCR. Furthermore, Sinopec challenged Eclipse's entitlement to apply for and hold the well licences pursuant to section 16 of the OGCA.

The AER has determined that it is unnecessary to consider whether Sinopec is eligible to request a regulatory appeal under section 38 of the REDA. Based on the following reasons, the AER finds that this

[2] Defined in Section 1.020(2)-4(b) of the OGCR.

[3] Eclipse Resources Ltd.'s *Regulatory Appeal Request Response submission*, dated January 9, 2024, paras. 5(e) and (f).

request for regulatory appeal involves, in substance, a private contractual dispute and is not "properly before it," under REDA, section 39(4)(c).

Based on the submissions, the AER understands that Sinopec is a beneficial working interest owner as a result of being the successor to West Energy, who entered into a contractual arrangement with Eclipse and Morichal. The AER finds that Sinopec's concerns are properly characterized as a private contractual dispute about the participation in the development of the NW ¼ of Section 04-050-05W5M. Sinopec's arrangement with Eclipse and Morichal is a matter of private contract law, which is better left to the courts. Contractual disputes, including the interpretation of contracts, are beyond the statutory mandate of the Regulator under the *OGCA* and the *OGCR*.

The AER notes that section 16(1) of the OGCA provides:

> 16(1) No person shall apply for or hold a licence for a well
>
> (a) for the recovery of oil, gas or crude bitumen, or
>
> (b) for any other authorized purpose
>
> unless that person is a working interest participant and is entitled to the right to produce the oil, gas or crude bitumen from the well or to the right to drill or operate the well for the authorized purpose, as the case may be.

To verify entitlement under section 16, in this instance, the AER relied on information from the Crown regarding whom it had leased its minerals to. The AER checked the Government of Alberta's publicly accessible Electronic Transfer System (ETS). A review of the ETS confirmed that Eclipse has leased petroleum and natural gas rights from the Crown for the Cardium Formation in the Northwest ¼ section of Section 04-50-5W5M and the North ½ of Section 05-50-5W5M. Eclipse and Morichal are the only parties registered on the ETS system as the lessees of the rights in the North ½ of Section 05-50-5W5M and the Northwest ¼ Section 04-50-5W5M. The AER is satisfied that Eclipse holds the requisite mineral rights in the subject lands to be a working interest participant and to apply for and hold the Well Licences.

The issue of whether Eclipse has complied with the AER's subsurface well spacing requirements is separate and distinct from the entitlement to apply for and hold a well licence under section 16 of the OGCA. Although it is not strictly necessary for the purposes of making a decision in respect of the request for regulatory appeal of the Decision, the AER will address this issue.

Sinopec raised concerns with compliance under section 1.020(1)(4) and 4.021 of the OGCR and both Eclipse and Sinopec raised arguments over whether the 12-05 Well and 13-05 Well can be produced from

the Cardium Formation in the Northwest ¼ of Section 04-50-5W5M and the North ½ of Section 05-50-5W5M in accordance with the AER's common ownership requirements. Section 7.3.1.6 of *Directive 065* states:

> If the ownership within a holding is common at the lessor level and uncommon at the lessee level but all lessees have agreed to work within the terms of the current holding, the ownership is considered to be common for the purposes of a holding. Such agreements are handled by the mineral owners and are dealt with outside of AER procedures.

Further, AER Bulletin 2014-027 and associated Frequently Asked Questions indicate that common ownership is satisfied in lands with separate holdings "where all mineral owners have an agreement on how to operate within the holding area (e.g., a joint operating agreement)".[4]

The AER is satisfied that the productive part of the 12-05 Well and 13-05 Well that encounters all three DSUs, across two holdings, meet common ownership requirements (Northwest ¼ of Section 04-50-5W5M and the North ½ of Section 05-50-5W5M). As stated previously in relation to the previous issue, contractual disputes related to the interpretation and effect of an agreement are beyond the statutory mandate of the Regulator under the OGCA and the OGCR.

In closing, the AER finds that concerns relating to the legal interpretation and enforcement of private agreements, such as the one between the parties, are outside of the AER's jurisdiction. Should Sinopec decide to pursue its contractual dispute with the courts and depending on the results, Sinopec may submit a separate complaint with the AER in relation to compliance under the relevant legislation and the AER will review the matter.

For the reasons noted above, AER has decided to dismiss the request for regulatory appeal in accordance with Section 39(4)(c) as the request is not properly before it.

Sincerely,

<Original signed by>

Paul Ferensowicz
Principal, Regulatory Advisor

[4] FAQs, *Rules and Procedures for Wells in Buffer Zones, Off-Target Wells in DSUs, and Special Well Spacing Applications, September 2014*, at A1.

<*Original signed by*>

Steve Thomas
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Evan Knox
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