

Faculty of Law

FINAL EXAMINATION - APRIL 2003

543:B1 BASIC OIL & GAS LAW (Percy)

Time Allotted: Two Hours.

Code Number: DO NOT ENTER YOUR NAME ON ANY ANSWER SHEETS OR BOOKLETS. A list will be circulated and your name is to be entered opposite a number on that sheet. That number will be your code number FOR THIS EXAMINATION ONLY and should be entered on the examination booklets in the space provided for surname. This will provide for anonymity during marking.

- Special Instructions:*
1. This examination consists of two parts. An examination supplement sets out **10** short answer questions on **6** pages. This main paper contains **1** question on **4** pages. You should answer the short answer questions on the examination paper provided and the main paper in an examination booklet.
 2. Answer **ALL** questions.
 3. This is a **CLOSED BOOK** examination. Copies of the course reading list have been provided with the examination. You must hand in this examination paper, together with your examination booklet and supplement at the end of the examination.

VALUE QUESTION

50 marks
*(Recommended
time: 60 minutes)*

1. Joanne Jackpot owns mines and minerals beneath a section of land northwest of Edmonton. On January 20, 1993, Jackpot entered into a petroleum and natural gas lease with Stewart Exploration. The lease included the following terms:

To Have And Enjoy the same [Jackpot's mineral estate] for the term of five years from the date hereof (hereinafter called the "primary term"), and so long thereafter as operations are conducted upon the said lands with no cessation for more than ninety consecutive days. Whenever used in this Lease, "operations" shall mean any of the following: drilling, testing, completing, re-working, deepening, plugging back or repairing of a well in search for or in an endeavour to obtain or increase production of the leased substances or any of them, or production of the leased substances or any of them (whether or not in

paying quantities) or operations for or incidental to the foregoing.

Delay Rental:

Provided that if operations for the drilling of a well are not commenced on the said lands or the pooled lands within one year from the date hereof, this Lease shall terminate and be at an end on the first anniversary date, unless the lessee shall have paid or tendered to the lessor on or before the said anniversary date the sum of \$320.00 (hereinafter called the "delay rental"), which payment shall confer the privilege of deferring the commencement of drilling operations for the period of one year from said anniversary date and that, in like manner and upon like payments or tenders, the commencement of drilling operations and the termination of this lease shall be further deferred for like periods successively.

Shut-in Wells:

If all wells on the said lands or the pooled lands are shut-in, suspended or otherwise not produced during any year ending on an anniversary date as the result of a lack of or an intermittent market, or for any cause whatsoever beyond the Lessee's reasonable control, the Lessee shall pay to the Lessor at the expiration of each said year a sum equal to the delay rental hereinbefore set forth, and each such well shall be deemed to be a producing well hereunder.

Stewart paid delay rentals on the land prior to the anniversary date of the lease in 1994, 1995 and 1996, but it conducted no operations on the land during that period. In November, 1996, Stewart agreed to assign its lease to Orange Petroleum Ltd. for a consideration that was described in the contract of the assignment as follows:

Stewart reserves to itself 40% of the net profits realized by Orange from the oil and gas produced from the properties assigned and conveyed to Orange. For the purposes of this agreement, "40% of the net profits" means "an interest in land entitling the assignors to receive 40% of the net profits realized from the properties assigned and

conveyed to Orange.” This clause shall bind the successors and assignees of both the assignor and the assignee.

Stewart immediately registered a *caveat* protecting its interest under the Net Profits Agreement. On January 19, 1997, Orange made a payment of the delay rental and in November, 1997, Orange arranged to farm out the drilling of a well on Jackpot’s land to Digger Drilling Ltd. under an arrangement in which Digger could obtain the Orange lease by drilling a well on Jackpot’s land. If the well was unsuccessful, Orange and Digger agreed that the lease would be allowed to lapse. If the well proved productive of either petroleum or natural gas, Digger would obtain 100% of Orange’s working interest in exchange for a gross overriding royalty, which was described as follows:

Gross Royalty:

Digger covenants and agrees to grant and assign to Orange a gross overriding royalty of 5% of Digger’s share of all petroleum, natural gas and related hydrocarbons produced, saved and sold from the said property.

Orange filed a *caveat* protecting its interest under the gross overriding royalty agreement. In December, 1997, Digger began operations to drill a well on Jackpot’s lands. Digger conducted the following operations:

1. On January 18th and 19th, 1998, Digger moved a partly dismantled rig onto the well site.
2. On January 20th, Digger began to prepare the rig at the well site and obtained a well license.
3. On January 21st, the derrick of the rig was raised to the vertical position.
4. On January 22nd, at 9:00 p.m., the well was “spudded in” and Digger began drilling operations.

After January 22nd, Digger continuously drilled the well to completion at a total cost of \$2 million. On February 4th, much to its surprise, Digger encountered a significant gas reserve. It immediately suspended the well and on February 8th, it obtained from the Energy and Utilities Board permission to cap the well. It finished operations to cap the well on February 12th and conducted no further activities on Jackpot’s land. On

February 16th, Digger delivered a shut-in royalty payment to Jackpot and made similar payments on January 19th in 1999, 2000 and 2001.

In February, 1998 Orange transferred its working interest to Digger and Digger confirmed the grant of the gross overriding royalty to Orange. Between 1998 and 2001, Digger attempted to negotiate a tie in a gas gathering systems in the area, but was unable to do so on terms which would allow Digger to obtain any net revenue from the well. In 2002, Digger became bankrupt.

The trustee in bankruptcy is in the process of disposing of Digger's assets and has asked you for an opinion on the following issues:

1. Is the lease under which Digger obtained its working interest still valid?
2. If the trustee decides to sell Digger's working interest will the sale be subject to the Net Profits Interest in favour of Stewart and the Gross Overriding Royalty in favour of Orange?
3. If the lease is invalid, is Digger entitled to any compensation from Jackpot?

Please provide the requested opinion.

End of Examination