

Scenario #5: Tie-ins and Spacing: An Issue of Fair Regulatory Costs

EXISTING ARRANGEMENTS: A Co. has discovered short life, shallow natural gas reserves in a five-section block of lands. A Co. has constructed a field gas gathering system with compression facilities (the "Facilities"). A Co. presently has five wells producing (one per section) and has recently made application for reduced spacing within its lands with a focus on drilling near the perimeter of its lands and adjacent to the Facilities (short tie-ins). Subsequently, B Co. drilled a well on its lands into the same pool and has tied in its well to A Co.'s Facilities under an interruptible, gas processing and transportation arrangement. This well is a major find and core asset for B Co., generating a major part of its current cash flow. B Co. has agreed to pay A Co. a gas-processing fee, which B Co. understands is based on the Industry's JP 95 Gas Processing Fee Guidelines. B Co. is the only third party producer in the Facilities at this time. For purposes of convenience and efficiency, A Co. has agreed to contract operate B Co.'s well.

Initial Assessment

Applying the elements of this case study to your own issue, consider the following analysis and questions:

- What is the emerging problem? What issues need to be addressed now to avoid regulatory action later?
- What common interests do companies have if they were to resolve the issues now?

COMPLICATING FACTORS: Frequently, B Co.'s well is shut-in because of its effect on operation of the Facilities while A Co.'s wells are produced into the Facilities. B Co.'s well is connected at the head of the Facilities and on a separate gathering line upstream from the majority of A Co.'s production. Geologically, B Co.'s well is down dip of A Co.'s wells and B Co.'s well is more prolific than any of A Co.'s wells but is producing water. A Co. designed the Facilities for sweet dry gas with design capacity at current pressures being more than double the current throughput. A Co. did not provide for pigging of the Facilities (flat prairie terrain) with near design throughputs anticipated at the time of construction.

Cost Benefit Risk Analysis

- What are the costs involved in taking regulatory action? What are the best and worse case scenarios? How can cost and risk best be mitigated?

GROWING TENSIONS: Increasingly, B Co. has become concerned that A Co.'s wells are draining its lands and that A Co.'s gas processing fee is exorbitantly high, particularly because the recoverable gas reserves under B Co.'s lands have a short production life. The Facilities have been designed for longer life reserves and will be salvageable by A Co. for its use elsewhere after A Co.'s lands are depleted. Given the interruptible service, A Co. has no issue in terminating its agreement with B Co., given the 30 days termination provision within the agreement. There are no other facilities in the area for B Co. to utilise without a significant capital investment in pipelines.

Potential Interests & Options

A Co. and B Co. seem to have incongruent interests. If A Co.'s application for reduced spacing is successful, additional drilling may result in greater utilization of the Facilities and a reduction in B Co.'s gas processing fees. If B Co. successfully opposes A Co.'s reduced spacing application, it is likely B Co.'s processing fees will remain exorbitant but the likelihood of greater drainage of B Co.'s lands is lessened.

APPROPRIATE DISPUTE RESOLUTION: In this instance, despite efforts by B Co. to address the issues fuelling growing tensions between the companies, assistance by the regulator was required. After assessing the situation, consulting with legal counsel and engaging an ADR service provider to help coordinate the file, B Co. determined it would oppose A. Co.'s application to the EUB for reduced spacing. With the assistance of an EUB facilitator, the underlying issue in dispute was successfully settled by the parties, improving access to the Facilities, reducing gas processing fees somewhat and accepting A Co.'s application for spacing, with some restrictions. As a result, the added costs of an EUB hearing intervention were avoided and the business relationship between the two companies, while not issue-free, remained intact.