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Developing Legal Trends in Oil and Gas Exploration in Québec

Over the past several years, there has been a marked increase in oil and gas exploration activities in Québec.

With the recent activity surrounding the shale gas discoveries and the spike in 2008 of energy prices, Québec has seen a number of significant investments for the exploration and development of its oil and gas resources and a marked increase in the value in the investments being made in order to further explore and develop these resources.



As this interest in Québec has grown so has the sophistication of the players who have recently entered the market.

Companies such as Forest Oil, Talisman, Questerre and Canbriam are but a few of the major players who have become actively involved in exploring and developing Québec's oil and gas resources.

Certainly, one of the unique aspects to Québec society, in addition to its unique geophysical characteristics, is the legal system in Québec which is founded on the Civil Code.

Many of the legal concepts for oil and gas exploration, which are somewhat standardized throughout North America, have their basis in Common Law and some of these concepts do not necessarily transfer directly into principles under Québec law.

The challenge for lawyers who are representing clients in this area has been to translate some of the concepts that are familiar to North American oil and gas developers and turn them into viable, existing contractual arrangements that will be accepted and enforceable under Québec law.

Farm-out and Joint Operating Agreements

The traditional model for oil and gas exploration and development outside of Québec is a farm-out and joint operating agreement.

The use of a farm-out and joint operating agreement has gained popularity in Québec as it allows for the continued use of commonly accepted provisions and has been adapted to Québec law.



Agreements (cont'd)

Although the terms of the actual farm-out agreements will vary, depending on the size of the investment, the interest to be earned by the farmee party and the duration of the obligations, there has been a movement towards having the standard 2007 Canadian Association of Petroleum Landsman (CAPL) operating procedure used as the basis for the ongoing relationship.



Many of us have had to familiarize ourselves with the concepts of “farmee”, “farmor”, “vertical stratigraphic wellbore” and, my favourite, “spud”.

Certain modifications have to be made to the CAPL operating procedure to be more reflective of Québec law but, for the most part, these changes are not significant.



Licenses and Permits

Québec is also unique in the sense that there is a central registry for all licenses and permits granted for oil and gas exploration, the information for which is readily available on-line.

We have also had the pleasure of working with representatives of the Ministry of Natural Resources and Wildlife and found them to be extremely cooperative and useful in helping us ensure that there is a practical yet comprehensive system of knowing where oil and gas exploration and development rights are located and who holds these rights.



Licenses and Permits (cont'd)

One of the challenges has been in properly registering various interests of parties, particularly for those who have made significant investments but whose interest in and to any permits or licenses will only vest upon the completion of their entire commitments.

This is one area where Québec law is quite different than those of other jurisdictions in that it is not yet possible to have an inscription made on a specific land title to indicate that the property itself is subject to an oil and gas permit.

In the Common Law jurisdictions, it would be possible to have a specific “*caveat*” registered on title which would be enforceable on any party who currently owns or subsequently acquires the land.



Register of Real Rights

In certain of the transactions that we have worked on, we determined that it was possible to create certain real rights in favour of various permit holders whether such persons are part of a farm-in group or a secured lender.

Under the Civil Code, by virtue of Article 2972, it is possible to create a separate register called the Register of real rights of State resource development in which could then be entered against each specific lot the permit affecting the lot.

Once the annotation has been made on the various lots upon which this register has been opened, all subsequent entries on the specific lot are made in this register and not on the immovable index itself.



Register of Real Rights (cont'd)

In accordance with the *Mining Act* (Québec), oil and gas exploration permits are real rights and these rights can be registered in accordance with this particular procedure.

Kindly note that in areas where the lots have been subdivided, namely in those areas where the lots have existed for quite some time, there can be a large number of lots covered which obviously increases the cost in order to have these lots properly surveyed and then registered.



Indivision Agreements

Since most of the oil and gas agreements involve some form of farm-in/farm-out relationship, there will become a time when the parties will likely have shared title to the permits and ultimately any leases over the territory.

Indivision agreements are essential in order to establish the rights of the respective permit holders, particularly vis-à-vis the management of the permits, any potential sale or transfer of the permits and other rights and obligations that one would typically find in any type of shared or co-owned property.



Indivision Agreements (cont'd)

Typically, in these types of agreements, we would deal with whether or not the parties have the ability to freely dispose of their respective interest, whether they would have to proceed by way of a right of first refusal or a right of a right of last refusal and other similar dispositions.

These agreements would also cover such issues as how defaults under the principal agreement will affect one's rights in and to the permits and basically how the parties will manage their own relationships as far as costs and maintenance of the permits.

Future Trends

So far, most of the recent oil and gas activity in Québec has consisted of the exploration and development phase as opposed to the production phase. As the discoveries become more significant, it would be expected that permit holders will go from being holders of a license to being holders of an oil and gas lease.

In order to obtain a lease, there are a number of conditions that would have to be satisfied, particularly those with respect to the commercial viability of producing oil or gas from the property covered by the permit.



Recent legislation with respect to the use, treatment and disposal of water will also be taken into consideration in whether a lease will be granted and under what conditions.

To the extent that some oil and gas discoveries will be located in populated areas, the holders of permits or licences will have to enter into their own arrangements with the property owners in order to cover such issues as indemnification, rights of access and other potential issues.

In many cases we foresee a standard form of agreement that could be signed with property owners regarding these issues in consideration of certain payments, whether in the form of an up front payment or an ongoing royalty.

Another potential issue will be whether the permits themselves or a production lease can be hypothecated in favour of a financial institution or other lender in order to construct facilities such as piping, reservoirs and other infrastructure equipment which would be necessary in order to extract, refine or transport oil and gas taken from the properties.

Again, given that these rights are real and immovable rights, we are of the view that it will be possible to hypothecate these rights through the register of resource development.

Conclusion

For many, the past few years have been quite exciting for the nascent Québec oil and gas industry. This industry has now reached a stage of maturity where there is an increasingly standard type of documentation that is acceptable to both the local and international players. However, no matter how well drafted, no matter how well negotiated, ultimately the ability to work in partnership depends on the good faith of the parties to the agreements.



Charles R. Spector - Biography

Practice focuses on public and private corporate financing, with particular emphasis on takeovers and mergers and acquisitions and project financing. Acts as lead counsel in many high profile, cross border files, advising both purchasers, sellers and other stakeholders. Acts on behalf of Canadian purchasers acquiring businesses outside of Canada as well as for foreign purchasers who are buying businesses in Canada. Acts on behalf of Canadian issuers and underwriters in debt or equity financing in the Canadian, U.S. and global capital markets. Acts as lead counsel to developers and sponsors of independent power projects and to lending institutions financing these projects. Recognized in LEXPERT Guide to the Leading US/Canada Cross-border corporate lawyers in Canada and International Who's Who of Project Finance Lawyers. Member of the Legal Advisory Committee for the Autorité des marchés financiers (Québec).