Is The Board Bored?

(ERCB Closure Order on a Drilled Well Due to a Perhaps Invalid Freehold Lease)

THE RECENT DECISION OF THE ERCB IN *DESOTO RESOURCES LTD., RE* (ERCB DECISION 2008-047) OFFERS A FASCINATING NEW WAY FOR LESSORS TO MESS WITH FREEHOLD LESSEES WITHOUT ALL THE TROUBLE OF GOING TO COURT. In *Desoto*, the ERCB decided that because the lessee "failed to satisfy the Board that is has sufficient entitlement for the purpose of holding a well license" it would cancel the license for a well which had already been drilled, suspend operations on the well by way of a Closure Order and issue an Abandonment Order "... in due course according to the Board's usual policy and procedures." Just in case you don't know, a Closure Order means the Board comes out and puts a great big lock on the wellhead. I checked the well license and it is in fact subject to Closure. Ouch.

OMG. What an absolutely brilliant way for lessors to go after lessees years before a Court decides whether a lease is valid and subsisting. I do not work for lessors very often, but this is a truly amazing method to bring the hammer down on lessees. As a lessee in Alberta you need to know how this works. Don't worry about me perhaps tipping off EnCana; they are the lesssor who brought the ERCB application in Desoto requesting that the Board review the well license.

The Test – Satisfaction of the Board

The Board relied on section 16 of the *Oil and Gas Conservation Act* to issue the Closure Order. Section 16 states in part that:

> 16(1) No person shall apply for or hold a license for a well... unless that person ... is entitled to the right to produce the oil, gas or crude bitumen from the well..."
>
> 16(2) If, after 30 days from the mailing of a notice by the Board to a licensee ... *the licensee fails to prove entitlement under subsection 1 to the satisfaction of the Board,* the Board may cancel the license or suspend the license on any terms and conditions that it may specify. (emphasis mine)

So the Board will, on the request of a lessor (or some other interested party I suppose), conduct a mini determination of lease validity. The whole Board process in Desoto took less than a year from EnCana's initial objection to the well license to the Board hearing. It took another 6 months or so for the Decision to be released, so we are talking less than two years all in.

Way quicker than a Court case and a way better remedy. Automatic well closure and probably an abandonment order in the pipe. Add to that the lack of costly discoveries, pre-trial motions or subsequent hearings on damages and costs and you have a great new way to go after a lease.

I don't know, but I imagine a Closure Order (with a pending Abandonment Order) kind of changes the negotiation dynamic between a lessor and a lessee in the Court case and settlement negotiations.

Bad Facts Make For Bad Decisions

One of the main problems in *Desoto* is that the facts are so bad for the lessee. I will not speak to this matter in detail as a Court case is in progress and I spent significant time in the past reviewing this actual lease for a third party. However, I will say this lease is on life support at best and I think the Board might have sensed this and decided in this case it could come to a decision of lease validity with some confidence its view would match the Courts view.

Yet, when I read the portion of the *Desoto* decision dealing with lease validity I am left wanting. A couple of examples will suffice:

- The Board talks of the primary term ending "unless extended under the terms of the lease..." and of the parties "...disagree on the exact date the primary term ended". The primary term of this lease ended on June 6, 1980, when the 5 year term was up. Full stop. Continuation beyond the primary term is the issue. Might just be semantics, but it bothers me to read about confusion as to when the primary term ended.

- The Board speaks to the lease being in a unit, but never discusses how the unit agreement would amend the term of the lease. It is crucial to understand that any lease within a unit has probably been amended so that unit operations are deemed to be operations under the lease. You cannot decide on lease validity without looking at the unit.

My point is not to attack the reasoning of the Board, rather to point out how difficult it is to get freehold lease validity questions right. You need lots of evidence. You need discoveries. You need rules of Court. Property rights are fundamentally important things that I would hope the Board would defer speaking about unless absolutely necessary to the performance of its regulatory function.

A Wee Question of Jurisdiction

Don't stop reading, this jurisdiction stuff is important, and I promise not to be totally boring.

It is indisputable that the ERCB has no jurisdiction at law to determine a contractual dispute between private individuals regarding whether a freehold lease is valid and subsisting. The Board is aware of this. They went to great lengths in the *Bearspaw Petroleum Ltd., Re* (EUB Decision 2007-024) CBM well licensing decision to confirm they had no legal right to decide on property law matters (substance ownership in Bearspaw and lease validity here). Again, just like in *Bearspaw* they pause just long enough to take a breath and then decide on exactly the matter that they have no jurisdiction to decide on.

In *Desoto* the Board gives its reasoning for predetermining a lawsuit by stating:

> While the Board is aware that the issue of lease validity is currently before the Court of Queen's Bench, it is of the view that it would not be appropriate for it to defer addressing this situation while awaiting a court determination of that matter.

Ok, well I guess that's it then. Bullet proof reasoning. No test, no threshold. Just a single sentence that it would not be appropriate to wait.

This is where I get a bit confused. I have a tough time understanding why it would be inappropriate to wait. Earlier in the decision the Board indicates that it denied an EnCana application to formally suspend the well license "...as EnCana had failed to show irreparable harm." I would have thought that would have been a crucial threshold test of the Board to consider before it exceeding its jurisdiction and make a decision that impacted private property rights for which a Court case already existed.

In fact, "irreparable harm" is the test the Courts themselves use to decide if extraordinary remedies should be granted to a plaintiff (the party who starts the lawsuit) before the final judicial determination. In my humble view a Closure Order (and subsequent Abandonment Order) is an extraordinary remedy if there ever was one. If you cannot show irreparable harm then the defendant gets to keep doing what the contract says he gets to do (i.e. drill and produce) until the final judicial determination of the matter.

I would have thought that the Board's jurisdiction under section 16 might more properly be exercised by:

- Determining if a prima facie contract exists (i.e. can you find a signed lease).
- If no lease can be found you're toast.
- If a lease exists, then considering if the lessor has a prima facie claim for lease termination.
- Then consider if irreparable harm would ensure if you allow the well license to stand (and the well to be produced) until a Court decides on the points above.
- If there is a possibility of irreparable harm, suspend the well until the Court decides (but do not force abandonment of the well).
- If the lessor cannot show irreparable harm, rely on the prima facie lease and wait for a Court to tell you otherwise.

But what do I know.

The *Desoto* decision was appealed to the Alberta Court of Appeal and leave to appeal was denied (ABCA 2008 Carswell Alta 1621). In a three paragraph decision the Court upholds the Board decision and states:

> There is no merit to the argument that the Board does not have jurisdiction to deal with the validity of the lease, at least to the extent and only to the extent of establishing entitlement to apply for the well license.

Bring the Rain

Therefore we now have Court blessing for the ERCB to hear applications on the validity of freehold leases. If they are not satisfied that your lease is valid, they will issue Closure Orders and Abandonment Orders for any wells on the lands, sans any consideration of what an actual Court might have to say about the lease.

This reminds me of one of my all time favorite movie moments. It comes from the epic action movie Transformers, right at the point when the army dudes are getting beat up by a robot. The army guy calls for an airstrike by telling the air force guys to "bring the rain". Truly poetic. The "rain" is immaculately depicted by an overwhelming aerial bombardment of the robot for a full 5 minutes. My 8 year old was actually curled up in ball in his seat in the theatre because the sound was so loud and the visual action so overwhelming.

I am reminded of this because if lessors take full advantage of the ERCB's willingness to hear these applications, lessees are going to feel like the robots getting pummeled by the airstrikes.

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