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Independent Operations, Holdings and Common Ownership: A Letter Decision of the Alberta Energy Regulator

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Case Commented On: AER, Request for Regulatory Appeal by Westbrick Energy Ltd., Regulatory Appeal No. 1852713, 25 May 2016

Last week, ABlawg announced a new three-step project which will present the Alberta Energy Regulator's (AER's) published procedural and participatory letter decisions in a more usable and accessible form. As noted in that post, step one of the project, which collates the summaries of these decisions in a searchable PDF document, is now complete.

The objective of this post is to provide an example of the potentially valuable nuggets of information discoverable in this large group of decisions. The post concerns a letter decision which, while ostensibly dealing with procedural matters, also contains discussions of holdings, common ownership and independent operations within the meaning of the 1990 CAPL Operating Procedure. As such, the decision confirms the importance of publishing these decisions insofar as joint operating agreements (JOAs) are common in the industry as is the practice "going penalty". But the decision also illustrates some confusion between the threshold question of standing and the decision on the merits. In this case it appears to us that the AER panel actually decided the merits of Westbrick's application and then somewhat perversely denied it standing.

Westbrick Energy Ltd. (Westbrick) and Lightstream Resources Ltd. (Lightstream) are joint owners (presumably as lessees) of the mineral rights in section 19-045-11W5 (Section 19), each holding an undivided interest. Westbrick and Lightstream executed a Joint Operating Agreement which incorporates a 1990 CAPL Operating Procedure (the Operating Procedure) to govern the parties' interests in Section 19.

Lightstream applied to establish a holding in Section 19 in accordance with section 5.190 of the *Oil and Gas Conservation Rules*, Alta Reg 151/1971 (*OGCR*) and Directive 065: Resources Applications for Oil and Gas Reservoirs (Directive 065). The AER granted that application. Section 79(4) of the *Oil and Gas Conservation Act*, *RSA* 2000, c O-6 (*OGCA*) provides that when a pool or part of a pool is within a 'holding', the provisions of the *OGCA* or *OGCR* may be varied or suspended by application. Although the Letter Decision does not disclose why Lightstream applied for the holding (nor what Westbrick sought to gain by having the holding repealed), many holdings are established to enable a party to apply for special well spacing that would allow for an increase in well density from the baseline.

Westbrick then brought this application for Regulatory Appeal pursuant to section 38 of the *Responsible Energy Development Act*, SA 2012, c R-17.3 (*REDA*). Section 38(1) of *REDA* provides:

> 38(1) An eligible person may request a regulatory appeal of an appealable decision by filing a request for regulatory appeal with the Regulator in accordance with the rules. (emphasis added)

The AER's decision in this case turned on whether Westbrick was an "eligible person", as defined in section 36(b)(ii) of *REDA*, which provides that an eligible person includes:

> a person who is directly and adversely affected by a decision of the Regulator that was made under an energy resource enactment, if that decision was made without a hearing. (emphasis added)

One of the requirements for a holding is that there is common ownership of the drilling spacing units at the lessor and lessee levels in accordance with sections 5.200 and 1.020(2)(4) of the *OGCR* and Unit 7 of Directive 065.

Westbrick submitted that when Lightstream filed its holding application, there was no longer common ownership in Section 19 because of the operation of the penalty provisions of the Operating Procedure. Westbrick submitted that when it elected not to participate in two independent operation wells drilled by Lightstream in Section 19, "the entire beneficial interest (100%) in the working interest held by the non-participant is effectively wholly transferred to those working interest holders who participated in the well."

According to the Letter Decision, the test for common ownership is found in section 1.020(2)(4) of the *OGCR* which requires, in part, when 'common ownership' is used in connection with a holding:

> (i) that the ownership of the lessors' interests through the block, holding or project is the same and the ownership of the lessees' interests through the block, holding or project is the same, or
>
> (ii) that the owners of the lessor's interests and the lessee's interests throughout the block, holding or project have agreed to pool their interests...

This was therefore the issue on the merits: did the application of the penalty provisions of the CAPL Operating Procedure destroy (or suspend) common ownership in Section 19. However, as the AER panel states at the outset of this "procedural decision" Westbrick can only be entitled to a regulatory appeal on this issue if it can show that it is a person "directly and adversely affected" by a decision of the Regulator. It should follow from this that the panel must first consider whether a working interest owner in a holding is a person that is directly and adversely affected (whether that person is in a penalty position or not) before turning to examine the merits of Westbrick's contentions with respect to common ownership. Since the establishment of a holding may allow the AER to vary or suspend the ordinary application of the regulations to a holding within which Westbrick had an undivided interest one might have thought that the answer should be yes. Certainly Westbrick must be "directly" affected. But the panel reaches the opposite conclusion (at least with respect to adverse effects) and seems to do so for two reasons.

First, the panel concludes that the penalty provisions did not disrupt common ownership and therefore there could be no adverse effect on Westbrick (this of course is a decision on the merits), and second (and the relevant part of the decision confirms that this is a second reason because it begins with the word "further"):

> … the adverse impact that Westbrick alleges is a result of it exercising its rights under the Joint Operating Agreement to not participate in the drilling of wells and be subject to the penalty provision. These consequences are not a direct or necessary result of the AER's decision to approve the holding. Whether or not Westbrick is adversely affected by a penalty provision under the Joint Operating Agreement is a decision by Westbrick to not participate in the well, thereby incurring the penalties set out in the parties' private agreement. As the potential adverse impact would be as a result of a voluntary decision by Westbrick to not participate in additional wells, Westbrick has not demonstrated that the adverse effect is a result of the AER's decision to approve the holding.

Clearly we need to know more about the way in which Westbrick pled its case in order to assess this conclusion. If the only adverse effect that Westbrick alleged was that it lost a share of production because it had gone penalty, then the panel must be correct. But if Westbrick alleges at least a *prima facie* case that the holding causes it some other prejudice as a co-owner then it would seem that Westbrick has established both a direct effect and an adverse effect.

But in any event let us examine what the panel has to say about the merits. As noted above, the panel concluded that the operation of the penalty provisions did not destroy or suspend common ownership. These apparently were not 'title preserving wells' as defined by the Operating Procedure, non-participation in which would have resulted in the forfeiture of Westbrick's mines and minerals interest in the wells and the applicable spacing unit, as defined in the Operating Procedure. The principal reason the panel gives for this is that "[o]wnership of lessee interests (beneficial or otherwise) remains unchanged by the penalty position that a nonparticipating party opts into" and "[a]lthough Westbrick may not be receiving the full benefit of its interests due to its election to go penalty, the requirement for common ownership remains met".

We agree. Each co-owner has the right to undivided possession of the whole. While tenants in common may alter their property rights through contract, the independent operations provisions of the Operating Procedure which address non-title preserving wells do not contain specific language which transfers or assigns any of the non-participating parties' ownership interest in the underlying mineral rights to explore and produce from the joint lands (i.e. the *profit à prendre*) during the cost recovery period.

Specifically, subclause 10.07A (which addresses the parties' respective rights during the cost recovery period of a non-title preserving well) does not expressly alter the parties' ownership interests. The specific language used in subclause 10.07A can be contrasted with other provisions of Article 10.00 which specifically provide that the non-participating parties will *forfeit* a specified interest in the joint lands. ('Forfeiture' expressly occurs with respect to title preserving wells and where a non-participating party elects – after cost recovery – not to accept participation in an independent well.)

It should be noted that even if Westbrick's contention were correct that the operation of the penalty provisions transferred an interest (which as noted above would be the case for a title preserving well), that would not itself prove Westbrick's case. Westbrick would also need to show that the ownership position was different in different parts of the holding. There is still common ownership in a holding if A and B each own a 50% interest throughout the holding or if B owns 100% of the holding. Common ownership is only disrupted if B owns part of the section

of land as 100% and another part between A and B as to 50% each. We don't have enough facts to assess what the position was here. This perhaps points to one generic difficult with these procedural decisions. They are often economical with the facts; facts which are no doubt well known to the parties but less accessible to the disinterested reader.

This post may be cited as: Nigel Bankes & Heather Lilles "Independent Operations, Holdings and Common Ownership: A Letter Decision of the Alberta Energy Regulator" (21 February, 2017), online: ABlawg, http://ablawg.ca/wp-content/uploads/2017/02/Blog_NB_HL_Westbrick.pdf