The ERCB asserts its jurisdiction to determine the validity of an oil and gas lease
by Nigel Bankes

In re Desoto Resources, Joffre Field, ERCB Decision 2008-47
http://www.ercb.ca/docs/documents/decisions/2008/2008-047.pdf

In an unusual decision the ERCB has asserted its jurisdiction to determine the validity of an oil and gas lease. While the Board has in recent years been forced to make rulings on complex questions of property law such as the competing rights of coal owners and natural gas owners to coal bed methane (*In re Bearspaw Petroleum*, EUB Decision 2007-24) as well as the competing interests of bitumen producers and natural gas producers (*Alberta Energy Company Ltd. v. Goodwell Petroleum Corporation Ltd.*, 2003 ABCA 277, reviewing EUB Decision 2000-21) this is, so far as I am aware, the first reasoned decision of the Board in which it has passed on the validity of an oil and gas lease. Desoto's application in the Court of Queen's Bench for a declaration as to the validity of the leases was pending at the time of the Board's decision.

This does not seem to have been a particularly hard case on the merits and thus the primary interest of the decision lies largely in the Board's assumption of jurisdiction in the matter. While Encana is still contesting the jurisdiction of the Board to determine ownership issues in the coalbed methane disputes (and indeed, and somewhat surprisingly from my perspective, has obtained leave to appeal on the point: *Carbon Development Partnership v. Alberta (Energy and Utilities Board)*, 2007 ABCA 343) there seems little doubt but that the Board must have jurisdiction to determine legal issues that arise (as they did here) in the course of exercising its statutory power to issue (or decline to issue or decide to cancel) a well licence.

The facts
Desoto applied for a well licence for a well (the 11-13 well) on section 13 to obtain production from Basal Belly River Sands. Shortly after the Board had issued the licence EnCana requested a review on the grounds that the leases on which Desoto relied were no longer valid and that therefore Desoto could not comply with s.16 of the *Oil and Gas Conservation Act*, R.S.A. 2000, c. O-6.

The leases in question were all granted in the mid-1970s by PanCanadian as predecessor to EnCana. The leases all provided that they would be continued at the end of the primary term "so long thereafter as any of the leased substances is being produced or is capable of being produced in paying quantities from a well or well on the said lands ….". A further proviso to the habendum dealt with the case of abandonment where the lessee engaged diligently and continuously in the drilling of a further well. The leases defined production in paying quantities as "the output from a well of such quantity of the leased substances or any of them as can be taken profitably having regard only to the costs of producing such substances and not to the costs of drilling such well."

Desoto claimed rights by assignment to all the lands except the Viking. The rights to the Viking were held by Pennwest and Cansearch and these parties held the leases in trust for

Desoto. The Viking lands were originally included in a unitization agreement. Production from this unit ceased in 1998 and as of 2003 EnCana took the view (and with the concurrence of Pennwest and Cansearch) that the leases had terminated in accordance with their terms. Desoto argued that there was a suspended (not abandoned) oil well (the 13-13 well) in the Viking zone (which last produced in 1985) and that the results of its new well (which it drilled pending this review decision and despite an undertaking not to), a reserves report on the Belly River, and drilling and production results from adjacent lands all demonstrated that the lands were capable of production in paying quantities.

The Board's decision

The Board concluded that the leases on which Desoto relied were no longer valid and that Desoto's well licence should be suspended.

The 13-13 well was not a well that was capable of production within the meaning of the lease. For a well to qualify it must be able to produce in paying quantities once the well is "turned on". There was no evidence that the 13-13 could produce. Furthermore, even if the primary term of the lease had been extended until the present 11-13 well were drilled, evidence of that well's potential output based on reserves analysis and testing information would not suffice to show that such a well was capable of production in view of the fact that the well was not tied in to a pipeline.

Neither was the lease continued under the abandoned well provision of the habendum for two reasons. First, it was not clear that the 13-13 well had been abandoned within the meaning of the lease. Abandonment of particular zones within a well was not abandonment of a well for the purpose of triggering this part of the habendum. Second, even if that part of the habendum were applicable there was insufficient evidence to show that Desoto had diligently and continuously prosecuted the drilling of a further well. Desoto had obtained a well licence to drill on the lands in 2003 but it never drilled and Desoto offered no evidence of its activities in contemplation of drilling between 2004 and its application for the 11-13 well in 2007. Thus, while it was unclear precisely when the primary term terminated (when the unit wells ceased production in 1998 or at some later time perhaps based upon an estoppel argument) it had certainly terminated prior to the drilling of the 11-13 well and the gap was not filled by diligent and continuous prosecution of drilling activities.

Desoto's licence should be suspended. It was not appropriate to await the outcome of Desoto's action in court. The Board noted that its practice in cases where a licensee was found not to have the right to produce the relevant minerals was to cancel the licence if no well had been drilled and to suspend it in the event that a well had been drilled. Liability continues to attach to licensees for matters related to a well even after the licence is suspended or cancelled and even after a well is abandoned.

The Board found it unnecessary to deal with the merits of Desoto's estoppel argument or EnCana's claim that the legal lessees Pennwest and Cansearch had surrendered the leases.

Discussion

As stated above I believe that the Board always has the jurisdiction to pass on questions of general law (property law issues, lease validity issues and contract interpretation issues) if they arise as a necessary part of the exercise by the Board of its statutory authority. The standard of review on appeal to the Court of Appeal will be correctness. But I also think that there will be no appeal of this decision. The Board has got it right. On the basis of the material adduced before the Board the primary terms of these leases had expired and while continued by unit production after the primary term they must have terminated in accordance with their own terms when production from the unit ceased. While there are hints of an estoppel argument it seems that such an issue will have to be raised at trial. And there we know that the case law suggests that any lessee faces a tremendous hurdle in establishing estoppel in an oil and gas lease scenario: *Weyburn Security Co. Ltd v. Sohio Petroleum Co* (1969) WWR 680 (Sask. C.A.), aff'd 74 W.W.R. 626 (S.C.C.); *Voyager Petroleums Ltd. v. Vanguard Petroleum Ltd* (1982), 17 Alta. L.R. (2d), aff'd (1983), 27 Alta. L.R. (2d) 1 (Alta. C.A.).