July 17, 2014

What Happens When an Insolvent Energy Company Fails to Pay its Rent to a Landowner?

Written by: Shaun Fluker

Decision commented on: *Petroglobe v Lemke*, 2014 ABSRB 401

The law in Alberta provides an energy company with the right of surface access on private lands to drill for oil and gas. This access allows the company, among other things, to construct an access road and clear lands for the well site. In most cases, the company and the landowner enter into a surface lease whereby the company agrees to pay rent in exchange for this access. In other cases, surface access is governed by a Right of Entry Order issued by the Alberta Surface Rights Board (website) whereby the company obtains access in exchange for the payment of rent. This case is about what happens when an insolvent company fails to pay its rent.

Surface access and the compensation payable by an energy company to a landowner is governed by the *Surface Rights Act*, RSA 2000, c S-24 (the text of the Act can be viewed here). Section 36 deals with situations where the company fails to pay its rent. Where a landowner provides the Surface Rights Board with satisfactory evidence of non-payment, section 36 obligates the Surface Rights Board to demand payment from the company:

> 36(3) Where any money payable by an operator under a compensation order or surface lease has not been paid and the due date for its payment has passed, the person entitled to receive the money may submit to the Board written evidence of the non-payment.
>
> 36(4) On receiving the evidence, if the Board considers that it satisfactorily proves the non-payment, the Board shall send a written notice to the operator demanding full payment.

Where the company fails to comply with this demand for payment, the Surface Rights Board has the power to extinguish the company's surface access rights and direct the Minister to pay the landowner (sections 36(5) and (6)).

We might then summarize these provisions simply as holding that Albertans collectively guarantee that a landowner will receive their rent as compensation for having to endure the disruptions to their quiet enjoyment brought by the oil and gas industry. The applicable

provisions in the *Surface Rights Act* include a mix of obligatory and discretionary language and thus do not literally suggest this is a guarantee, however section 36 has been judicially interpreted as some form of guarantee for landowners. In *Provident Energy v Alberta (Surface Rights Board)*, 2004 ABQB 650 Justice Erb stated:

> [27] In my opinion, the purpose of Section 36 of the Act is obvious. It is to provide a mechanism by which the surface owner is guaranteed payment of the compensation to which he is entitled whether the compensation has been fixed by an agreement or not. In order to carry out its duties in some sensible fashion, the Board would have to determine whether the lease was valid and whether compensation was payable to any party and by whom. As Sirrs J. held in the Devon case, the application of Section 36 is discretionary and even if a land owner shows sufficient evidence that a lease exists, the Board is not bound to order compensation. If the Board was bound to do so, this would amount to a fettering of its discretion.

Which brings us to the Lemke decision at hand. In 2006 Doug and Marg Lemke entered into a surface lease with Petroglobe in relation to a well operated by the company. The Lemkes filed evidence with the Surface Rights Board to demonstrate: (1) they are the registered landowner of the subject lands; (2) there is a valid surface lease between the parties; and (3) that Petroglobe failed to pay its 2013 rent under the lease. This documentation satisfied the Lemkes' obligation under section 36(3) to demonstrate non-payment of rent.

The twist in this case is that Petroglobe was insolvent and, according to the Surface Rights Board decision, was assigned into bankruptcy in October 2013 pursuant to section 50.4 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (the *BIA*) (the text of the *BIA* can be found here). The Surface Rights Board held that the *BIA* precludes it from proceeding with a section 36 application for payment of rent. The decision itself has very little reasoning to support this ruling other than citing provisions of the *BIA* which, generally speaking, state no proceedings outside of the *BIA* process may be commenced against an insolvent person who has made a proposal to its creditors or has been assigned into bankruptcy, and the Supreme Court of Canada's *Canadian Western Bank v Alberta*, 2007 SCC 22 decision for the principle that a federal statutory provision trumps a provincial provision in cases of incompatibility.

The Surface Rights Board essentially ruled the doctrine of federal paramountcy means section 36 of the *Surface Rights Act* is inoperable in this case because a section 36(4) claim for non-payment of rent is not allowable under the *BIA*. The Surface Rights Board has applied similar reasoning in other recent cases as well (See eg *Pahl v Magnus One*, 2013 ABSRB 331 here).

There are a number of problems with this decision which are magnified by the fact the Surface Rights Board appears to have taken this position generally. The reasoning provided by the Surface Rights Board for such a complex suite of legal issues including statutory interpretation and constitutional matters is unsatisfactorily brief. The result here seems absurd and defeats the purpose of the *Surface Rights Act* to ensure that a landowner is compensated. And finally, it isn't clear to me that there is incompatibility between the *Surface Rights Act* and the *BIA* in these cases. Section 36(4) requires the Surface Rights Board to issue a demand notice to the insolvent company for payment of rent. In a case like this where the company does not pay, it is Alberta taxpayers who are potentially on the hook for the bill not the insolvent company.