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An Important Alberta Crown Lease Continuation Decision

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Case Commented On: *APL Oil & Gas (1998) Ltd v Alberta*, 2025 ABKB 201 (CanLII)

In the natural resources sector, as in so many other industrial sectors that require major capital investments in physical assets, security of tenure for those engaging in exploration activities (resource lessees) is foundational. And a crucial part of security of tenure for a resource lessee is the expectation that, if they make a discovery, they will be able to hold on to that discovery at least until they have recovered all their investment including a return on risk capital, or better yet, until the discovery has been fully exploited and is no longer profitable to produce. On the other hand, the resource owner (whether private or public (Crown)) wants to ensure diligent exploration and development by the resource operator/lessee, failing which the property should be returned to the owner so as to allow the owner to explore other potential lessees.

Leasing systems (private or public) seek to balance these different interests. These leasing systems evolve over time as the industry matures in any particular jurisdiction – from a wildcat province with few, if any, exploration wells to a mature basin. In Alberta's oil and gas industry, the principal mechanism for the 20% of lands that are freehold mineral rather than Crown is the private or freehold lease form. There is no standard form lease although particularly common lease forms are the various iterations of the lease adopted by the Canadian Association of Petroleum Landman (CAPL) now known as the Canadian Association of Land and Energy Professionals (CALEP). Speaking generally, the lease form achieves the balance referenced above by providing the lessee with a short primary term (2 to 4 years) at the end of which the lessee will only be able to proceed to a secondary term if the leased lands are producing (or at least that the lands are capable of production but shut-in for some unavoidable reason). The secondary term is typically open ended and continues for so as the lands are producing or capable of producing in economic quantities. What is significant for present purposes is that there is a truly massive body of complex case law on the private oil and gas lease, much of it concerned with continuation decisions (or in the language of the freehold lease, moving from the primary term to the secondary term and the ultimate cessation of production). The late John Ballem did a masterly job of synthesizing this case law in successive editions of *The Oil and Gas Lease in Canada*. While the last decade has seen a significant drop-off in reported freehold lease litigation, there is still a significant body of case law on which practitioners rely when interpreting freehold leases. Perhaps the most fundamental point is that the courts and not the administrative state have held the last word when it comes to interpreting the continuation provisions of freehold oil and gas leases.

The province faces a similar challenge in designing a leasing system, although as the owner of 80% of the resource it has significant market power and thus has much more authority than a single private owner to set rules that are favourable to the government as owner on behalf of the public

(subject to the risk that a jurisdiction that is over dependent on resource revenues assumes the status of a petrostate beholden to the interests of industry). Alberta's continuation rules for conventional petroleum and natural gas have been remarkably stable for close to thirty years with the adoption of the *Petroleum and Natural Gas Tenure Regulation*, Alta Reg 263/1997 (PNGTR) in 1997 to supplement the bare-bones provisions of Part 4 of the *Mines and Minerals Act*, RSA 2000, c M-17 (*MMA*). Yet, despite that longevity, and in stark contrast with the position in relation to freehold leases, there has been virtually no litigation on the PNGTR since its adoption and of the few cases that exist, none until the *APL* case that is the subject of this post have focussed on lease continuation. See: (1) *Prairiesky Royalty Ltd v Yangarra Resources Ltd*, 2023 ABKB 11 (CanLII) at para 98 (dealing principally with the registry system under the *MMA* and the characterization of a gross overriding royalty, see ABlawg post here), (2) *IFP Technologies (Canada) Inc. v EnCana Midstream and Marketing*, 2017 ABCA 157 (CanLII) at para 33 (dealing the relationship between co-owners and the terms of a joint operating agreement, ABlawg posts here and here) and (3) *Adeco Exploration Company Ltd. v Hunt Oil Company of Canada, Inc.*, 2008 ABCA 214 (CanLII) (dealing with the allocation of liability between joint operator when the operator fails to seek timely continuance, ABlawg post here).

I think that the principal reason for the absence of litigation on continuation issues can be attributed to the perception, driven in part by the early decision in *R v Industrial Coal and Minerals Ltd.*, 1977 ALTASCAD 213 (CanLII) (*ICM Case*), that continuation decisions under the prevailing regime were essentially unreviewable given the subjective language of the statute and deference to ministerial decision making. Here is what the Court of Appeal had to say in the *ICM Case*:

> The appellant took the position that it was entitled to continue the lease it had upon the land because there was "a producing well" as required by s. 126 (1) (a) of *The Mines and Minerals Act,* being chapter 238 of the Revised Statutes of Alberta 1970. Whether or not the abandoned well was a "producing well" depends upon s. 109 of *The Mines and Minerals Act.* That section defines "producing well" in s. 109 (b) as follows:
>
> > "(b) 'producing well' means a well that is, in the opinion of the Minister, capable of production of petroleum or natural gas in paying quantity."
>
> It is clear that the Minister put his mind to this question. He advised Industrial Coal and Minerals Ltd. that he would not continue the lease as he did not find "in his opinion" that the well abandoned more than 21 years before was, without re-entry, "capable of producing natural gas in paying quantity". That was the Minister's decision - it is final and is not to be reviewed as to its validity in this type of proceeding. The Minister had the power and the duty to decide. He did so and that is an end of the matter. We think that this decision was eminently reasonable. (at paras 2-3)

But 50 years is an eternity in administrative law and this decision of Justice Rick Neufeld demonstrates that the reasoning discipline imposed by the Supreme Court's decision in *Vavilov* (*Canada (Minister of Citizenship and Immigration) v Vavilov,* 2019 SCC 65 (CanLII)), invites greater scrutiny of negative lease continuation decisions.

The Continuation Provisions of the PNGTR

Rights to Crown petroleum and natural gas in Alberta may be granted either by way of a licence or a lease. The main elements of the scheme (omitting some of the detail) are as follows. A licence may be issued for an initial term of 2, 3, or 5 years depending upon the area of the province (PNGTR, s 7). In order to continue the licence at the end of its initial term, the licensee must have drilled a validating well. A validating well need not identify commercial accumulations of hydrocarbons, but it must be "drilled for the purpose of evaluating petroleum and natural gas rights in the location of the licence" (PNGTR, s 9). The concept of a validating well is perhaps best thought of as a work commitment. In some cases a well may qualify as a validating well (as here) even if it is not drilled on the agreement location but instead on an adjacent location – provided that the well has the evaluative purpose referenced above. A validating well allows the licensee to select sections of lands (down to the depth of the validating well) contained within the location of the licence to be continued into the intermediate term of the licence (PNGTR, s 11). The intermediate term of a licence is 5 years (PNGTR, s 5(1)(b)).

In some cases, rights may be issued in the form of a lease rather than a licence. Section 81 of the *MMA* provides that a lease issued July 1, 1976 has an initial term of 5 years. The rules for continuing a lease after its initial term and the rules for continuing a licence after its intermediate term are the same (PNGTR, s 12): namely the licensee or lessee (together, "agreement holder") must establish the existence of a producing well on the lands, or that the lands are "productive" as to all or part of the location. Both are defined in similar subjective terms as the relevant provisions at the time of *Industrial Coal and Minerals*. Thus, a producing well is "a well that is considered by the Minister to be a producing well on the basis of the records of the Regulator and other information available to the Minister" (PNGTR, s 1(q)) (emphasis added). Similarly, a part of the location may be "productive" if the "well or zone" is "capable, in the opinion of the Minister, of producing petroleum or natural gas from the well or zone in paying quantity" (PNGTR, s 1(r)) (emphasis added).

Continuation is assessed by the Department on a spacing-unit-by-spacing-unit basis. Hence, some parts of the location of an agreement may be approved for continuation while others may be rejected. In order to maximize its prospects for a favourable continuation decision the agreement holder needs to file its application in advance of the expiry of the agreement's term and support such application with relevant information. The Department of Energy (now Energy and Minerals) has provided significant guidance to the industry as to continuation applications under the PNGTR through the Technical Guidelines for Continuation, (updated 2021) as well as Information Letters such as IL 2018-05, Validation of Initial Term Licences and Continuation of Petroleum and Natural Gas (PNG) Leases and Intermediate Term Licences (February 12, 2018).

For example, the Technical Guidelines offers further guidance on the term "productive" as follows:

> A spacing unit is considered productive for oil and gas if:
>
> - there is at least one productive well in the pool,

- mapping supported by other technical information is supplied by the lessee (Alberta Energy will not generate mapping for the lessee) that demonstrates the presence of a productive pool, and

- the mapped productive pool underlies the spacing unit in the opinion of Alberta Energy [...] (as quoted by *APL* at para 13)

The Information Letter in turn advises that an applicant for continuation might request a meeting with Departmental officials to share information and discuss technical issues.

While the above describes the basic scheme there is one important additional option. An agreement holder may seek to qualify additional spacing units in its agreement as *potentially* productive in return for payment of a prescribed fee (PNGTR, s 17(4)). This option may serve to extend the initial term of a lease or the intermediate term of a licence by one year, at the end of which the agreement holder must, once again, establish productivity as per s 15 discussed above.

Once a lease or licence has been continued under s 15 it is continued indefinitely subject to the need to re-establish productivity within a year should the minister serve on the agreement holder a notice under s 18 of the PNGTR to the effect that the Minister considers all or part of the agreement to be no longer productive. If an agreement holder cannot establish productivity to the satisfaction of the Minister, the agreement expires at the end of the notice period (s 18(8)).

The APL Facts

APL acquired a PNG licence by way of a bonus bid of $1.3 million for 4 Sections of land (10, 11, 15 & 16) in 2013. APL's licence had an initial term of 4 years. APL drilled a validating well on section 9 (not part of the location – but see above). Based on that validating well, the Minister granted an intermediate term extension to the original licence to the entire area of the licence for five years (expiring August 15, 2022) for the zones evaluated by the well, namely the area below the base of the Winterburn Group to the base of the Beaverhill Lake Group (at para 6).

APL filed a first continuation application on April 7, 2021 seeking an advanced ruling as contemplated by s 14(1)(b) of the PGNTR. The Department responded "indicating that it would grant one year's continuation under s. 17 of the *Regulation* for Section 10 of the Lands, but would deny continuation for Sections 11, 15, and 16." (at para 12) In response, APL engaged two consulting firms (Sproule and McDonald) to support its original application, indicating amongst other things that the "Duvernay reservoir exists across the Lands and is uniform in thickness at approximately 23 metres of gross pay." (at para 16 and similarly at para 17) The Department in turn reacted with a second continuation offer (August 12) proposing: to extend Section 10 indefinitely under s 15 of the PNGTR, to grant a one-year continuation under s 17 for Sections 15 and 16, and to deny continuation for Section 11 – but also advising that APL could submit additional information before the offer expiry date of September 12, 2022 (at para 19).

This led APL to request meetings; first a request on August 18, 2022 for a technical meeting followed up by a request on August 29, 2022 for a meeting with legal counsel present. APL was advised that request for a meeting with legal counsel was "unusual". A technical meeting did occur

on September 2 without legal counsel. Justice Neufeld's summary of that important meetings (based on the Department's notes disclosed as part of the formal record) reads as follows:

> [The Department's] notes indicate that APL was confused as to why the technical data was insufficient, given that it revealed no geological difference between the various sections of the Lands. They also indicate that Alberta Energy stated that the Section 9 Well supported continuation under s. 17 of the *Regulation* for Sections 15 and 16. Alberta Energy also clarified that Section 11 was too far away from this well to satisfy continuation under s. 17. Alberta Energy elaborated that it had made a policy decision years ago not to allow s. 17 applications based on "mapping." APL later indicated that in this meeting, Alberta Energy advised that Section 11 was not considered productive because it was not within one spacing unit (in this case, a section) of a productive well. (at para 22)

APL continued to press for a meeting with counsel and to argue that Section 11 was productive. The Department declined the request for an additional meeting and held firm on Section 11. In the end, APL accepted the Department's s 17 offer for Sections 15 and 16 and sought an internal review of the Department's decision on Section 11. The Minister made a final decision denying continuation for Section 11 on October 14, 2022 (the first continuation, or the 2022 continuation decision).

Since Sections 15 and 16 were only provisionally continued under s 17 of the PNGTR for an additional year, it was necessary for APL to renew its continuation application for those lands (second continuation application, or the 2023 continuation application). The Department provided an initial and final decision rejecting the second application. The final review decision did offer additional reasons for the rejection (these reasons are reproduced at para 52). These reasons emphasized that there was no well on the Section 15 lands, or within a spacing unit of the lands and noted also that APL had not done any further work on the lands during the intervening year.

APL sought judicial review of the first and second continuation decisions on reasonableness grounds and on the basis of breach of obligations of procedural fairness (reviewable on the standard of correctness).

Reasonableness Review

Justice Neufeld began by referring to the commercial nature of continuation decisions before referencing *Vavilov* and noting the importance of examining the reasons offered by the decision-maker to assess "whether the decision reveals an internally coherent and rational chain of analysis that can be justified in light of the factual and legal constraints on the decision maker." (at para 45) With respect to the first continuation decision Justice Neufeld agreed that the reasons offered by the Department were conclusory and not responsive to the submissions made by APL:

> … the reasons failed to provide coherent reasoning for reading into s. 15(1)(e) a requirement that the lands to be continued be less than one section from a spacing unit containing a productive well. Such a requirement is not apparent from the plain language of that subsection of the *Regulation*. Moreover, APL's position was very clearly premised on its interpretation of the subsection. This is reinforced by APL's requests to have legal

> counsel present at the September 2022 Meeting and to have the meeting recorded, both of which were denied. This is also evident in the questions submitted by APL's counsel regarding the manner in which Alberta Energy was interpreting s. 15 (1)(e). It was reasonable for APL to expect, and is reasonable for the Court to require, that a thoughtful explanation of Alberta Energy's position be provided so that the decision can be properly understood and evaluated. (at para 51)

As noted above, the Department provided more detailed reasons for the second continuation decision but in Justice Neufeld's opinion that did not make them any more coherent insofar as they appeared to be based on the false premise that s 15(1)(e) of the PNGTR requires that there be a well on the subject lands, or within a spacing unit of those lands.

> The problem is that s. 15(1)(e) does not contain the wording that Alberta Energy posits. It provides that "a lease qualifies for continuation [...] as to a part of its location that is within [...] a spacing unit all or part of which is productive from a zone in the location": *Regulation*, s 15(1)(e). This does not connote any requirement to base a continuation application solely on wells within a spacing unit (which is dealt with under subsection 15(1)(a) in any event), nor on productive wells within a certain distance. (at para 53)

In sum, neither decision was supported by internally consistent reasoning that grappled in a thoughtful manner with the central arguments of APL.

Much the same conclusion followed from an analysis of the legal and factual constraints within which the Department was operating. For example, while it might have been possible for the Department to articulate an interpretation of s 15(1)(e) that supported the spacing unit /section "rule" in a way that was consistent with the modern approach to statutory interpretation (text, context, and purpose) the Department had not done so.

> To properly interpret s. 15(1)(e) of the *Regulation* and the argument advanced by APL regarding the sufficiency of mapping, the decision-maker ought to have considered the purpose and objectives of the continuation provisions as a whole, the manner in which the continuation provisions work together, how and why decisions on productivity are made, and how Alberta Energy's various information letters and guidelines inform those processes. With that foundation, the ultimate decision either to accept or reject APL's argument that the technical data was determinative of eligibility for indefinite continuation under s. 15(1)(e) could have been articulated in a transparent and justifiable way, as required by *Vavilov*. (at para 62)

By contrast, APL was unsuccessful with all of its procedural fairness arguments. Given the *Baker* factors (*Baker v Canada (Minister of Citizenship and Immigration)*, 1999 CanLII 699 (SCC)), the content of the duty of procedural fairness owed by the Department was at the lower end of the spectrum and the Department had met its obligations. In particular, APL had not established a legitimate expectation that it was entitled to a second meeting prior to the first continuation decision since there had been no clear and unequivocal assurance to that effect. The case contains an interesting discussion of whether APL should, on fairness grounds, have been provided with

the Department's internal assessment of the reserves reports that APL had provided in support of the second continuation application in order that it could know of and address the Department's concerns. The discussion suggests that had the Department's assessment of these reports been pivotal to its determination of productivity there might have been a case for disclosure, but since that was not the case there was no breach of duty.

As for a remedy, Justice Neufeld rejected APL's suggestion in final argument to the effect that the court should order lease continuation for entire balance of the original leased lands (i.e. for Sections 11, 15, and 16). In a carefully worded paragraph Justice Neufeld concluded that this would be judicial overreach and inconsistent with the balance reflected in *Vavilov*:

> … I consider it important for reviewing courts to exercise restraint in deciding a remedy for an unreasonable decision, as defined in *Vavilov*. Unless a decision turns on a very straightforward question of law, the Court should respect the expertise and specialized knowledge of the decision-maker by remitting the decision back for reconsideration, without dictating the analytical approach to be used or the result. If, after thoughtful reconsideration, a decision is reached in a transparent and organized way, that decision should withstand any further judicial review. In the long run such an approach will improve the quality of administrative decision-making and reduce the need for judicial intervention for the benefit of all involved. (at para 94)

Accordingly, Justice Neufeld quashed both continuation decisions and remitted both continuation applications back to the Department for reconsideration, with the additional caveat that the lands in question not be reposted for sale pending that reconsideration.

Conclusion

This is an important case for four main reasons. First, continuation decisions are crucially important decisions in the resources industry. Second, the case is only one of a bare handful of judicial decisions dealing with continuation. Third, and perhaps most importantly, the case confirms that continuation decisions, even when framed in subjective discretionary terms are amenable to substantive as well as procedural review. Fourth, the availability of judicial review on substantive grounds is clearly enhanced by the more demanding standard of reasonableness review articulated by *Vavilov*. More specifically, the decision suggests that it will be difficult for a statutory decision-maker to rely on a rule of thumb approach to the exercise of statutory discretion (in this case the apparent "rule" to the effect that lands more than a drilling spacing unit/section away from a producing well will be deemed non-productive) absent clear statutory language supporting such a rule, or internally consistent and articulated reasons justifying such a conclusion. While I doubt that the decision will open the floodgates, I do anticipate that we may see more Crown tenure holders, disappointed by adverse decisions on their continuation applications, seeking review of those decisions – or at least greater transparency in that decision-making process.

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