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on record

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The Shut-in Clause:

the meaning of “capable of producing the leased substances”

by Rosalind Greenwood

The meaning of the phrase “capable of producing the leased substances” in the shut-in clause of a standard oil and gas lease remains a point of contention in the oil and gas industry. At issue is whether the phrase refers strictly to the existence of producible gas in the ground, or extends to the physical readiness of the well.

With respect to the words “capable of producing,” the literature does not suggest, at any point in the evolution of the clause, that the focus was the physical readiness of the well. In other words, “capable of producing” does not appear to have been linked to whether the well itself was fully operational.

The Energy Resources Conservation Board (“ERCB”) recently considered this question in May of this year¹. It concluded that, for a shut-in or suspended well to be “capable of producing the leased substances”, the word “capable” means

...a present or existing ability or fitness of a thing to perform its purpose in the manner intended. Therefore, in the case of the 100/5-4 well, it must have been able to be “turned on,” and if any work were required for the well to attain or maintain the ability to produce the leased substances, in particular work falling within the definition of “operations” under the lease, the well would not be capable of producing the leased substances within the meaning of the suspended wells clause².

To date, this issue has not been the subject of any judicial consideration in Canada. That said, the Applicant/Appellant in the ERCB decision has been granted leave to appeal by the Alberta Court of Appeal. Madam Justice Paperny speaking for the Alberta Court of Appeal in the leave application held that the interpretation of the phrase “capable of producing the leased substances” is a question of law not fully within the ERCB’s expertise. A date to hear this decision has not yet been finalized.

Despite the dearth of discussion in the jurisprudence, the evolution of the shut-in clause itself provides some useful background to understanding what is meant by the phrase “capable of producing the leased substances.” The shut-in well clause was introduced into freehold lease agreements to address situations where an oil company-lessee drilled a well on a freehold owner’s lands, found gas, but could not sell the gas for lack of a market. The underlying rationale was that, given the efforts of an oil company-lessee in establishing its interest in the gas, it should be able to retain this interest until markets for the gas developed.

With respect to the words “capable of producing,” the literature does not suggest, at any point in the evolution of the clause, that the focus was the physical readiness of the well. In other words, “capable of producing” does not appear to have been linked to whether the well itself was fully operational. This is likely the result of the fact that the physical capability of the well falls under the rubric of “operations” as used in the lease. “Operations” under the standard oil and gas lease include:

drilling, testing, completing, reworking, recompleting, deepening, plugging back or repairing a well or equipment on or in the said lands or injecting the substances by means of a well, in search for or in an endeavour to obtain, maintain or increase production of any leased substances from the said lands...

The absence of any discussion in the shut-in clause regarding the physical capability of the well is an indication that a well’s physical readiness is not caught within the scope of the shut-in clause. Simply put, the why and wherefore of the words “capable of producing” in the shut-in clause appears to have everything to do with whether there is producible gas in the ground, and little or nothing to do with the physical completeness of the well itself.

This assertion is supported by the Freehold Owners Association’s suggested modifications for the shut-in clause of the CAPL 91 Lease. It recommends several revisions, but at no point suggests including words addressing the physical capability of the well. The absence of any mention thereof suggests an industry understanding that the words “capable of producing” are not tied to the physical readiness of the well (or at the very least, the chief focus of these words is the existence of gas and not the existence of a completed well).

The Alberta Court of Queen’s Bench’s decision in *Kissinger Petroleum Ltd. v. Grover*³ [“*Kissinger*”] is also instructive. Though *Kissinger* is ultimately about whether a shut-in payment can be made prior to the completion of a well, it may serve as a useful analogy. The case stands for the conclusion that a well need not have reached the stage where it has been tested and found to be potentially productive before payment of the shut-in royalty can be made. Therefore, it could be similarly argued that a well need not be physically completed when determining whether the well is “capable of producing the leased substances”, particularly when, as discussed above, the focus of these words is the gas reserve and not the physical well itself.

In conclusion, it is arguable that an incomplete well may not be sufficient to terminate a lease in that the evolution of the shut-in clause indicates that the focus of the words “capable of producing” was not the physical readiness of the well itself, but rather the existence of producible gas reserves. The history and purpose of the shut-in clause as well as the law’s willingness to reward individuals for their efforts suggests the scale may tip in favour of interpreting the phrase as referring to producible gas in the ground only, and not the physical readiness of the well. At the very least, the Alberta Court of Appeal’s grant of leave to appeal the ERCB decision suggests this is an issue of broad significance to industry and we will report further once the Court of Appeal has rendered its decision.

Footnotes

¹ ERCB Decision 2009-037

² *Supra*, Note 1, at para. 6.4

³ (1984), 45 A.R. 393 (Q.B.), *aff’d* 13 D.L.R. (4th) 542, leave to appeal to S.C.C. refused 13 D.L.R. (4th) 542

Interpreting an AMI Clause: Is a Pooling Agreement an Acquisition?

by Elizabeth Toews, Student-at-Law



Introduction

On November 2, 2009 the Honourable Mr. Justice A.D. Macleod of the Court of Queen's Bench of Alberta released his judgment in *Hunt Oil Company of Canada, Inc. v. Shell Canada Limited*¹ ("Hunt Oil"). The case involved a dispute between Hunt Oil Company of Canada, Inc. ("Hunt") and Shell Canada Limited ("Shell"), both of whom were parties to a Farmout Agreement. The Farmout Agreement permitted the parties to participate on a 50/50 basis in the other's acquisition of Lands. Shell entered into a pooling agreement with a third party, and the question was whether the pooling agreement was an "acquisition" such that Shell had to give Hunt the right to participate.

Facts

In 2003, Hunt and Shell entered into a Farmout Agreement with the following material terms:

- Hunt could earn a 50 percent working interest in certain lands previously acquired by Shell ("Block A" and/or "Block B" lands)
- Hunt could earn this interest by drilling a well.

- The Farmout Agreement contained an Area of Mutual Interest clause (the "AMI Clause") permitting the parties to participate on a 50/50 basis in the other's "acquisition" of Mutual Interest Lands.

Hunt acquired a 50 percent working interest in the Block A lands. However, both Hunt and Shell agreed that the Block B lands were not economically attractive on their own. They agreed that these lands would only be attractive if they could be pooled with the adjacently owned Talisman Energy Inc. lands (the "Talisman Lands"). The Talisman Lands fell within the AMI as defined in the Farmout Agreement.

Hunt did not elect to drill a well on the Block B lands and suggested instead that it acquire a working interest in the Block B lands by making a payment to Shell (thereby extending its ability to drill). Shell denied this request and Hunt's deadline to drill expired, leaving Hunt with no interest in the Block B lands.

Approximately 4 months later Shell and Talisman concluded a pooling agreement (the "Pooling Agreement") between the Block B lands and the Talisman Lands, which turned out to be highly profitable.

Issue

Hunt argued that Shell was obliged to provide Hunt with an AMI Notice, thereby giving Hunt the right to participate in the Pooling Agreement.

Decision

Justice MacLeod found that Shell was under no obligation to include Hunt in the Pooling Agreement.

Deciding Factors

Purpose of an AMI clause

The Court found that the purpose of an AMI clause is to avoid potential competition between parties when acquiring interests in adjacent lands. The Court found that Hunt did not have the ability to acquire an interest (through pooling) in the Talisman lands because it held no interest in the Block B lands. Hunt could never have acquired an interest (through pooling) in the Talisman Lands, and as such there was no competition to "guard" against.

No acquisition in Pooling Agreement

The Court noted that a "pooling" is financially neutral, that is, neither party gains or loses an interest in land. Upon concluding the Pooling Agreement, Shell had no greater interest in land than it had held prior to concluding the agreement. Shell cannot be said to have "acquired" an interest in land.

No Consideration to be paid by Hunt

The Farmout Agreement provided that where the AMI clause was triggered, the party electing to participate in the acquisition would have to bear the "corresponding share of the cash consideration of that acquisition". When Shell entered into the Pooling Agreement, there was no consideration to be paid—this was taken by the Court as an indication that the Farmout Agreement did not contemplate that a pooling agreement would constitute an acquisition.

Concluding Thoughts

Justice Macleod was careful to point out that he was not drawing any general rules about the scope of AMI clauses. Farmout agreements must each be interpreted based on the terms therein. Parties to a Farmout Agreement can achieve clarity and certainty through a careful drafting of the definition of "acquisition in the AMI clause".

Footnotes

¹2009 ABQB 627

Waiting for the Legislature to Decide: the Mines and Minerals Act and Underground Storage Rights

by Rosalind Greenwood

Introduction

Section 57 of the *Mines and Minerals Act* deals with storage rights within underground formations. The incorporation of this section into the *Mines and Minerals Act* in 1994 was expected to accomplish three broad changes, one of which was to clarify the ownership of storage rights and facilitate the disposition of these rights. The changes were largely the result of discussions between the Department of Energy and the Oil and Gas Industry over the course of several years, with respect to developing a generic policy for underground storage facilities. It was hoped that s. 57 would bring uniformity, certainty and a sound legal basis to the development of new underground storage facilities and the granting of storage rights.

Unfortunately, s. 57 has not accomplished the intended goals of the Legislature. The problem with s. 57 is twofold: first, the meaning of “storage” within s. 57 is not clear, in that it is uncertain whether the term extends to, for example, salt water disposal and Carbon Capture Storage (“CCS”); and second, it is not 100% clear whether s. 57 applies to freehold interests in mines and minerals, or whether it applies only to Crown interests.

What is the Meaning of “Storage” in s. 57 of the *Mines and Minerals Act*?

The Legislation, Judicial Consideration, Texts & Dictionary Definitions

The term “storage” in s. 57 is not defined in the *Mines and Minerals Act* or in the leading oil and gas texts, nor has the term been judicially considered by the Alberta courts or the Energy Resources Conservation Board (“ERCB”).

The term “store” is defined in *Black’s Law Dictionary* as “[t]o keep (goods etc.) in safekeeping for future delivery in an unchanged condition” and in the *Canadian Oxford English Dictionary* as “a place where things are kept for future use or sale” and to “keep or accumulate for future use.”

It is arguable that the term “storage” in s. 57 should be interpreted according to the above dictionary definitions, thus being specific to substances that are put into a subsurface cavern, only to be produced back to the surface at a later date. Although this is a reasonable interpretation of the term storage per s. 57, common sense and commentary by Nigel Bankes, Professor of Natural Resources, University of Calgary Law School, suggests there is reason to believe this is not the correct interpretation.

Commentary by Nigel Bankes

In his commentary on the Alberta Government’s September 30, 2008 Interim Report entitled *Accelerating Carbon Capture and Storage in Alberta* (“the Report”), Nigel Bankes¹ notes that the Report is written as though storage rights include disposal rights. That is, the Report uses the terms “storage” and “disposal” interchangeably to describe the last stage of the process whereby carbon dioxide is captured, injected, and ultimately disposed into the ground for geologically significant periods of time (i.e., 10,000 years). Although the focus of the Report is the development of a CCS network in Alberta, the Report’s comments on storage and disposal rights, as well as its use of the terms interchangeably, may apply in understanding the meaning of “storage” within s. 57 of the *Mines and Minerals Act*. Further, indicia that the term “storage” includes “disposal” is that the Oil and Gas Industry generally refers to the disposal of carbon dioxide as “Carbon Capture and Storage.”

Of interest is that the Report stresses the need for further clarification by the Legislature with respect to pore space ownership and disposition/storage rights. The Report calls for clarity in the legislation to ensure that “storage” in the *Mines and Minerals Act* includes disposal; and, that owners of freehold disposal rights are able to grant disposal rights to others by way of contract.

The Report addresses the fact that the ERCB understands CCS development to be comprised of three overlapping categories: sequestration/disposal; storage; and use in Enhanced Oil Recovery. Moreover, the ERCB refers to the permanent disposal of carbon dioxide as “sequestration.” This usage suggests that disposal and storage may refer to two separate actions.

Yet, the ERCB’s Directive 55, which sets out the storage requirements for the upstream petroleum industry, discusses the requirements of both “temporary storage” and “permanent storage.” To confuse matters further, Directive 55 defines “storage” as “[t]he holding of materials produced, generated, and used by the upstream petroleum industry for a period of time until the products or wastes are transported, treated, or disposed.” It should also be noted that the *Oil and Gas Conservation Act* and several rules in Alta. Reg. 151/71, both of which the ERCB is responsible for administering, distinguish between “storage” and “disposal”, in that the terms are listed separately in the same sections/regulations.



Summary

In light of the above discussion, it is clear that the term “storage” has several meanings, is used interchangeably with the term “disposal”, and is used inconsistently in legislation, regulations and/or ERCB publications. That said, the interchangeable use of “storage” and “disposal” in the Report, the recognition of “permanent storage” in Directive 55, Industry’s reference to the disposition of carbon dioxide as “Carbon Capture and Storage” and the absence of an explicit definition of “storage” in the *Mines and Minerals Act* itself or in the jurisprudence and/or academic literature, suggests that the term “storage” in s. 57 may be construed broadly to include disposition. Ultimately, however, this issue is likely up for debate until the Legislature clarifies s. 57 with new or amending law.

Does s. 57 Apply to Freehold Interests in Mines and Minerals?

Introduction

The *Mines and Minerals Act* does not explicitly state that s. 57 applies to freehold interests in mines and minerals. Yet, a close examination of the wording of the Section, as well as the Legislative debates surrounding s. 57, suggests that s. 57 does apply to Freehold interests. It should be noted that, to date, s. 57 does not appear to have been judicially considered.

The Wording of Section 57

There are several indicia in s. 57 suggesting that it applies to freehold interests in mines and minerals.

First, there is the use of the term “person” throughout the Section. If the Legislature’s intent were to restrict s. 57 to Crown interests in mines and minerals only, using the term “person” (rather than “the Crown”) would be nonsensical and lead to confusion. Moreover, such a reading would render Subsection (4) of s. 57 superfluous, which reads: “In subsections (1) to (3), “person” includes the Crown in right of Alberta.”

Second, Subsection (4) is also indicative of the term “person” referring to more than just the Crown. This is evidenced in the use of the word “includes”, which suggests that more than one body/party is represented by the term “person”. If the term “person” was meant to refer exclusively to the Crown, then the Subsection would read something to the effect of: “In subsections (1) and (2), “person” means the Crown in right of Alberta.”

Finally, the specific reference to the Crown in Subsection (5) (“Where the Crown in right of Alberta owns storage rights....”) would be inconsistent with the rest of s. 57 if “person” meant “the Crown in right of Alberta.”

Legislative Debates

Although not explicitly stated in the Legislative debates, it can be inferred from the Legislature’s stated purpose of s. 57, that, in order to clarify ownership and facilitate the disposition of underground storage rights, the Legislature intended for both Crown and freehold interests in mines and minerals to be addressed by s. 57. Not to include freehold mines and minerals interests under the purview of s. 57 (which comprise approximately 20 per cent of Alberta’s mineral rights according to the ERCB web site) would result in obscurity and confusion (given that there would be no legislation in place to deal with freehold underground storage rights), the very thing that s. 57 is in place to prevent.

What Does This Mean?

The wording of s. 57 and the Legislative debates surrounding the section indicate that s. 57 applies to Freehold interests in mines and minerals. The principles of legislative interpretation require that we read the words of a statute contextually, so that effect is given to the purpose and overall intention of the legislation. That is, the scheme of the statute and the intention of the legislature must be followed. Where there is ambiguity, the Supreme Court of Canada has affirmed that the cardinal rule is to read the statute in a manner that will not result in an absurdity. To read s. 57 as applying only to Crown interests in mines and minerals would lead to such an absurdity.

Where to Now?

The crux of a recent conversation with legal counsel from the Ministry of Energy was to the effect that the confusion surrounding s. 57 is an issue that Legislature will have to deal with in the near future, particularly given that Carbon Capture Storage is such a hot topic.

Concluding Thoughts

Although strong argument can be made that the term “storage” as used in s. 57 means “storage or disposal” and that it applies to both Crown and freehold mineral rights, ultimately this is an issue for the Legislature. In the words of Nigel Banks: “We support the idea that legislative action/clarification is needed. We cannot wait for the courts to sort out pore space ownership problems [and I would add salt water storage and Freehold problems]. Experience with similar types of issues (coal bed methane (CBM) ownership, gas over bitumen, and phase ownership issues) suggest that it will take far too long if we leave these issues to the courts.”

Footnotes

¹ http://ablawg.ca/wp-content/uploads/2008/11/blog_nb_jp_response_interim_report_nov2008.pdf

Court of Appeal Revokes ERCB Due to Lack of Appropriate Consultation with Landowners

by Jerrad Kubik

Background

On October 28, 2009, the Alberta Court of Appeal (“Court of Appeal”) ruled in favour of Susan Kelly, Linda McGinn and Linda Duperron (“the landowners”) and referred the matter of Grizzly Resource Ltd.’s (“Grizzly”) application to drill two sour gas wells back to the Energy Resources Conservation Board (“the ERCB”) for a rehearing.

The Court of Appeal’s decision in *Kelly v. Alberta (Energy Resources Conservation Board) and Grizzly Resources Ltd.*¹ (“the Kelly decision”) stems from a January 16, 2009 decision by the ERCB which denied the landowners standing to be heard in relation to a Grizzly application to drill two sour gas wells on the same piece of property near Rocky Rapids, Alberta. The landowners lived 2.9 km., 6 km. and 5 km. from the well site respectively. All three of the landowners’ residences were located *outside* of the established 2.11 km. Emergency Planning Zone (“EPZ”) for the wells in question but *within* the 9.25 km. Protective Action Zone (“PAZ”) that had been established around the Grizzly wells.

EPZ and PAZ

The EPZ is defined in the ERCB’s Directive 71 as being “the geographical area surrounding a well, pipeline, or facility containing hazardous product that requires specific emergency response planning.” The concept of a PAZ was added to Directive 71 in July 2008, and Grizzly’s sour gas well application was one of the first to be considered by the

ERCB after its addition. The area encompassing a PAZ is defined in Directive 71 as being the “area downwind of a hazardous release where outdoor pollutant concentrations may result in life threatening or serious and possibly irreversible health effects on the public”. The area encompassing a PAZ is based in large part on the direction and velocity of the prevailing wind conditions in the area and is intended to assist first responders with prioritizing emergency response actions.

ERCB Decision

The landowners filed formal objections with the ERCB upon being notified of Grizzly’s initial application, but these objections were dismissed by the ERCB on the basis that the landowners were not directly and adversely affected by the drilling of the wells. The ERCB granted the Grizzly licences on November 28, 2008 and the wells were subsequently drilled.

On December 16, 2008, the landowners then requested that the ERCB review and vary its decision regarding the Grizzly wells and its decision regarding the landowners’ lack of standing with respect to the wells. In a letter dated January 16, 2009 the ERCB dismissed these requests, finding that the landowners did not establish the requisite standing required to bring the Review Application forward. The ERCB ruled that while the landowners did reside within an established PAZ for the Grizzly wells, this fact alone was not sufficient in establishing that they had



Well Licences

rights that may be directly and adversely affected by the decision to approve the Grizzly application. The ERCB also stated that, because the landowners did not own land or reside within a specifically prescribed notification or consultation radius (i.e. the EPZ), the onus was on them to establish that they would be directly and adversely affected in a different way or to a greater degree than members of the general public. According to the ERCB, beyond residing within the PAZ and raising general concerns about the Grizzly wells, the landowners did not provide any substantive evidence that their rights may be directly and adversely affected. The landowners' concerns were again dismissed by the ERCB.

The Court of Appeal Decision

The landowners appealed to the Court of Appeal which found that the ERCB had erred in several instances.

The Court of Appeal found that the ERCB had misstated the test for standing that is required in order to challenge an ERCB decision. The correct test for standing, established in the Court's *Dene Tha' First Nation v. Alberta (Energy and Utilities Board)*¹ decision, employs both a legal and factual requirement. The Court of Appeal stated that the ERCB Directives 56, 60 and 71 created specific legal rights for the landowners as residents of the PAZ and, therefore, they had met the first requirement to establish standing. In relation to the second

requirement, the factual one, the Court of Appeal looked at whether the application before the ERCB may have directly and adversely affected the legal rights of the landowners established in the first part of the test. The Court of Appeal found that there was no basis for the ERCB's finding that the Appellants were required to establish that they may be affected in a different way or to a greater degree than members of the general public. The Court of Appeal then concluded that the landowners met both requirements for standing and that Directive 71's definition of a PAZ alone is sufficient to indicate that the landowners, as residents within an established PAZ, may be directly and adversely affected as a result of a hazardous release from the Grizzly wells. While the onus of proof was originally on the landowners to establish that they resided within the boundaries of the established PAZ, the Court of Appeal found that the onus should have then shifted to Grizzly to prove that landowners *would not* be potentially adversely affected by the wells.

Despite the fact that the Grizzly wells had already been drilled and completed without incident, the Court of Appeal overturned the ERCB's decision and ordered a rehearing of the Grizzly well application.

Subsequent Steps by the ERCB

In light of the Court of Appeal decision, the ERCB temporarily suspended the issuing of any licences for sour wells, facilities and pipelines. On Friday, November 13, 2009, the ERCB lifted the temporary suspension and released Bulletin 2009-41. Bulletin 2009-41 outlines changes to the emergency response modelling parameters used to calculate the PAZ endpoint, as well as significant changes to the processes associated with the public involvement programs set out in Directives 56 and Directive 71. Rather than occurring after construction but prior to the operational phase of a project as was the case previously, notification of residents within the EPZ of a proposed project must now occur prior to the submission of an application under Directive 56.

Concluding Thoughts

The Court of Appeal's Kelly decision underscores the importance of the correct implementation of the ERCB's public notification and consultation processes. Under section 26(2) of the *Energy Resource Conservation Act*², the ERCB is required to give notice and an opportunity to be heard to a person where it appears its decision on an application may directly and adversely affect the rights of that person. Nowhere within section 26(2) is there a requirement that that person must be affected in a different way or to a greater degree than members of the general public. The subsequent changes announced by the ERCB in Bulletin 2009-41 are an attempt to ensure compliance with the Court's ruling in relation to the scope of the public involvement programs set out in both Directive 56 and Directive 71. As the Kelly decision demonstrates, improperly notifying and consulting persons who may be directly or adversely affected by the approval of an application can result in unforeseen and significant delays, increased costs, and, ultimately, the reconsideration of a previously approved application.

Footnotes

¹2009 ABCA 349

²2005 ABCA 68

³R.S.A. 2000, c. E-10

The Language of Efforts

by Mark Henderson, Student-at-Law



Introduction

The terms “best efforts”, “reasonable efforts” and “commercially reasonable efforts” are often included in commercial contracts. As the terms impose different obligations on the signing parties, it is important to understand the meaning of each term.

Best efforts

Of the three phrases, “best efforts” presents the most onerous obligations for the party having to make those efforts. The meaning of “best efforts” was clarified in *Atmospheric Diving Systems Inc. v International Hard Suits Inc.*¹ (“*Atmospheric Diving*”) where the Court listed seven distinguishing factors of the “best efforts” standard:

1. “Best efforts” imposes a higher obligation than a “reasonable effort”.
2. “Best efforts” means taking, in good faith, all reasonable steps to achieve the objective, carrying the process to its logical conclusion and leaving no stone unturned.
3. “Best efforts” includes doing everything known to be usual, necessary and proper for ensuring the success of the endeavour.
4. The meaning of “best efforts” is... not boundless. It must be approached in the light of the particular contract, the parties to it and the contract’s overall purpose as reflected in its language.
5. While “best efforts” of the defendant must be subject to such overriding obligations as honesty and fair dealing, it is not necessary for the plaintiff to prove that the defendant acted in bad faith.
6. Evidence of “inevitable failure” is relevant to the issue of causation of damage but not to the issue of liability. The onus to show that failure was inevitable regardless of whether the defendant made “best efforts” rests on the defendant.
7. Evidence that the defendant had it acted diligently, could have satisfied the “best efforts” test, is relevant evidence that the defendant did not use its best efforts.

The point was clearly made in *Atmospheric Diving*, after a review of a number of cases, that where parties include a “best efforts” clause in a contract, they must surely intend that “something more than reasonable efforts” be used.

The seven distinguishing factors for the “best efforts” standard were endorsed in Alberta in the case of *Amonson v. Martin Goldstein*.²

A helpful note for drafters or those who are entering a contract with “best efforts” language, is that the best efforts requirement is more limited in the case of government bodies. Where public policy issues arise that conflict with the best efforts obligations in a contract, these public policy concerns will supersede the contractual “best efforts” requirement.³

Reasonable Efforts

The concept of “reasonable efforts” is not well defined.

Certainly it appears on its face to be a less onerous obligation than “best efforts”. Commentary from an Ontario case, *Ontario*

(*Ministry of Transportation*) v. *O.P.S.E.U.*⁴ indicates that it may be easier to define “reasonable efforts” by what it is not: “reasonable efforts” does not connote “all efforts”, “every effort” or “efforts to the point of undue hardship”. Instead “what it means is efforts that are reasonable in the circumstances, all things considered. What is reasonable in the circumstances will obviously, depend on the facts of particular cases”⁵

Commercially Reasonable Efforts

The meaning of “commercially reasonable efforts” was discussed in the case of *364511 Ontario Ltd. v. Darena Holdings Ltd.*⁶ (“Darena Holdings”). There the numbered company (“Delta”) entered into an offer to lease an arena from Darena. The offer was conditional upon Delta obtaining the required approvals to operate a bingo hall on the premises. Delta had been unaware of the strong opposition by the public and city council to the operation of the bingo hall and upon becoming aware, concluded its chances of succeeding with its application did not look good and abandoned a formal application. Darena argued that Delta had not made “reasonably commercial efforts” to obtain the approvals as required by the offer.

The trial judge noted he could find no judicial authority on the meaning of “reasonable commercial efforts” and referred to the ordinary dictionary meaning of the words as follows:⁷

- a) “Reasonable” implies sound judgment, a sensible view, a view that is not absurd.
- b) “Commercial” means having profit or financial gain as opposed to loss as a primary aim or objective

The trial judge concluded that the standard of “reasonable commercial efforts” meant that if Delta had a doubt from the efforts made, that no approval would be granted; it could conclude its efforts would be unsuccessful and could withdraw from the transaction. While the Court of Appeal⁸ in this case agreed with the trial judge in terms of the outcome, that Delta had made all reasonable commercial efforts in the circumstances, the Court of Appeal did not agree that “a simple doubt” about the prospects of success would be enough to enable a party to withdraw from a transaction. In the words of the Court of Appeal, rather than simple doubt, “uncertainty that made it commercially unreasonable to proceed was required”⁹.

It was interesting that the Court of Appeal commented that it did not find it necessary or useful to define “reasonable commercial efforts” in terms of “good faith”, “bona fides” or “best efforts.”¹⁰

The Darena Holdings case was followed in the more recent case of *Nelson v. 535945 British Columbia Ltd.*¹¹ (“Nelson”) wherein the Court held that the obligation pursuant to “all reasonable commercial efforts” involved a requirement

to pursue the matter up to the point where it became commercially unreasonable for them to proceed further. Further, in *Nelson* it was held that the addition of the adjective “all” before “reasonable commercial efforts” was found not to create a higher standard than “reasonable commercial efforts.”¹² According to Mr. Justice Ehrcke in *Nelson*, either efforts were commercially reasonable or they were not.

Concluding Thoughts

When a party sees one of these three terms in a contract, it should be aware of the level of flexibility available to the party who will have the obligation. To this end the parties are wise to clarify the standard by which the obligation will be measured, and to ensure that this standard conforms to what the parties intend and expect.

Footnotes

¹ (1994), 89 B.C. L. R. (2d) 356 (B.C.S.C.)

² (1994) 27 Alta L.R. (3d) 78.

³ *Wentworth Developments Inc. v Calgary (City)* [1998] A.J. No. 252 (Alta Q.B.)

⁴ 1997 CarswellOnt 6197

⁵ *Supra*, Note 4, at para. 46

⁶ [1998] O.J. No. 603 (Ont. Gen. Div.)

⁷ *Supra*, Note 6, at para.59

⁸ *364511 Ontario Ltd. v. Darena Holdings Ltd.* [1999] O.J. No. 1784 (C.A.)

⁹ *Supra*, note 8 at para.5

¹⁰ *Supra*, note 8 at para.4

¹¹ 2007 [2007] B.C.J. No. 2282

¹² *Supra*, Note 11, para.37

Update – Bitumen Valuation Methodology (BVM)

by Alicia Quesnel

Oil sands producers have been anxious to see proposed January 1, 2010 amendments to the current density based BVM established by the Crown under the Bitumen Valuation Methodology¹ (Ministerial Regulation), (the “BVM Regulation”) to a “gross product worth” (GPW) methodology to account for quality differentials. However, they will need to wait a bit longer. On January 14, 2010, Alberta Energy issued Information Letter 2010-02 advising industry that “until further notice, the current density based approach” to quality differentials, as set out in the current BVM Regulation, will “continue to be used to determine the value of bitumen disposed of in non-arm’s length transactions where there are insufficient third party sales to determine a fair market value.”

Many oil sands producers are of the view that the current density based BVM Methodology overstates the value of certain types of bitumen produced in Alberta for royalty calculation purposes. They hold this view because there is no discount for quality differentials between the bitumen produced from a specific project and the bitumen reference prices used in the BVM Methodology.

In a news release issued June 30, 2008, Alberta Energy introduced the current density based BVM Methodology as an “interim approach” that would be put in place effective January 1, 2009 until January 1, 2010. The final approach, to be put in place by January 1, 2010, would be the GPW methodology to calculate bitumen quality differences. In the June 30, 2008 news release, Alberta Energy noted that the GPW method provides a more detailed approach to calculating bitumen quality differentials for each oil sands project. The GPW approach “recognizes that bitumens with similar overall densities can have different compositions and so different values. There are a wide variety of bitumens in Alberta, with different recovery techniques that affect their quality.”

Alberta Energy has indicated in the January 14, 2010 Information Letter that it is “continuing to evaluate the appropriateness of a GPW approach.”

Footnotes

¹ A.R. 232/2008



Catholic Charities Feed the Hungry Program

On January 17, 2010 BD&P sponsored and hosted its 10th annual Feed the Hungry Dinner at St. Mary's Cathedral Hall. BD&P donated the cost of the entire meal and approximately 85 BD&P lawyers, staff and family members as the volunteers for the day, who were involved in a variety of ways from meal preparation, table seating, food and beverage service to clean-up. This year the endeavour fed 530 hungry Calgarians with 850 meals. It was a humbling and rewarding experience for our volunteers who will be eager to help again in January 2011. The BD&P volunteers along with the dinner guests were treated to the wonderful music of the Calgary Jazz band, Rassama Jazz, who entertained throughout the meal.

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