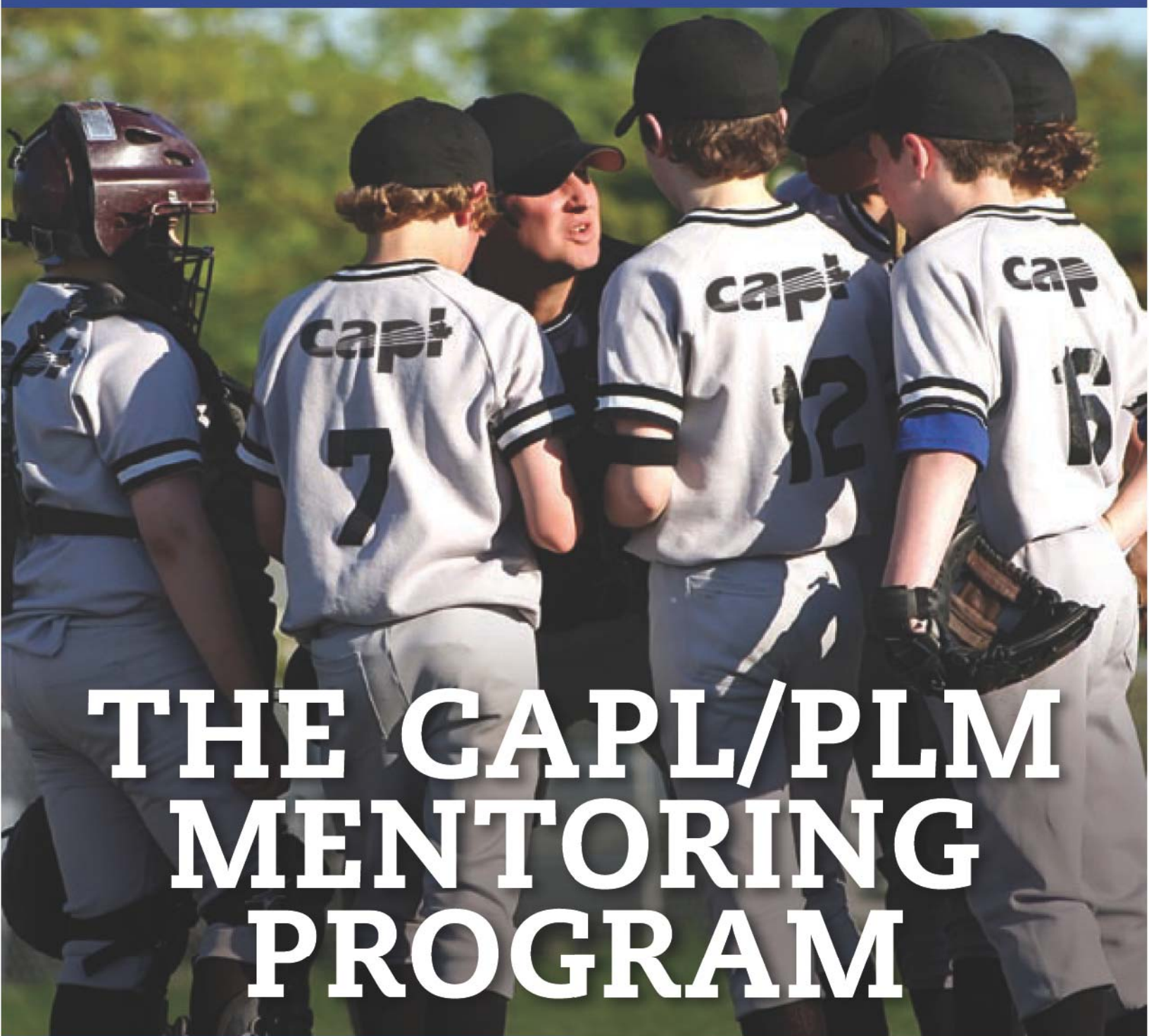


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THE CAPL/PLM MENTORING PROGRAM

Is "Producible" Even a Word?

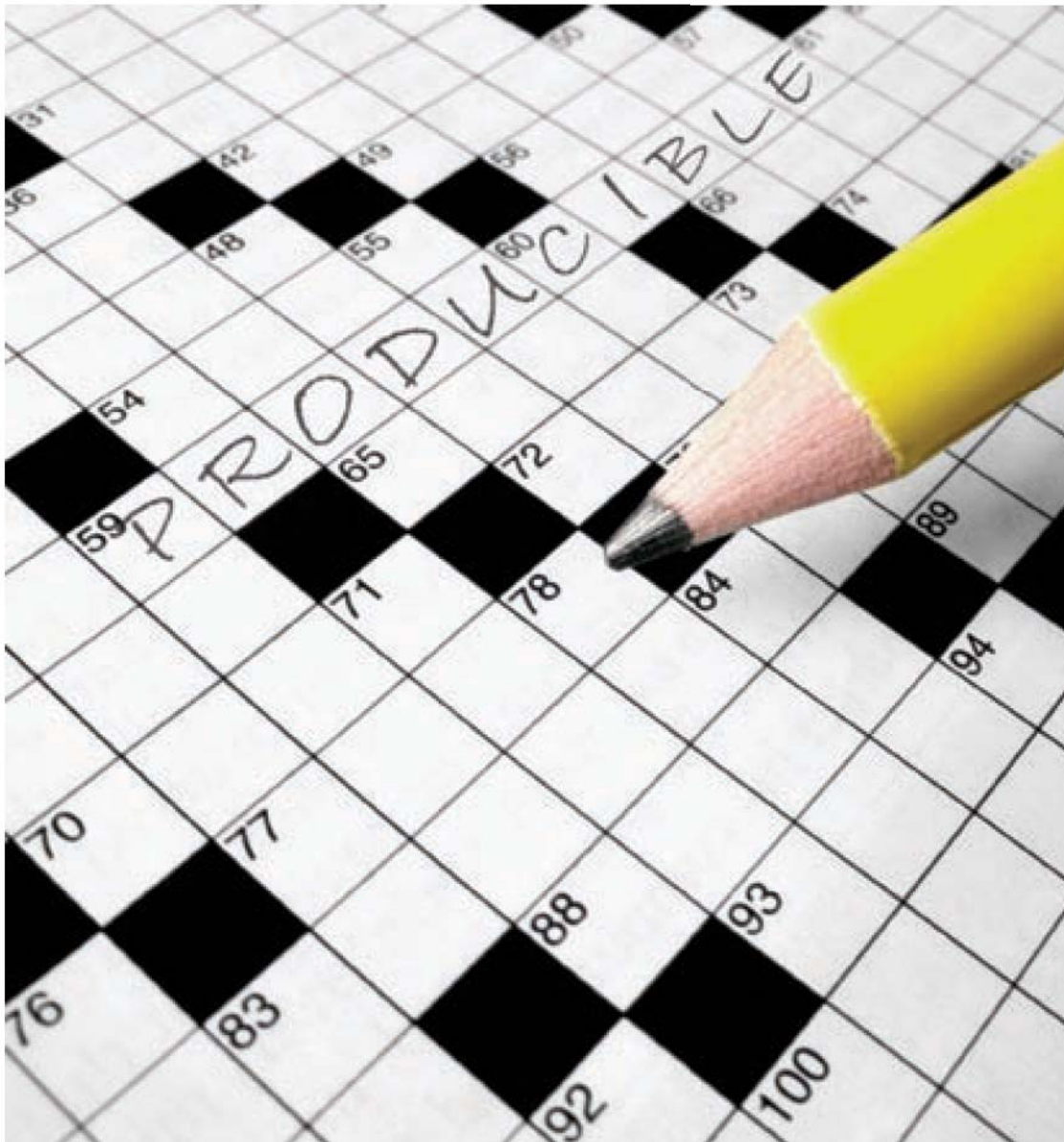
Producible, Capable and
Other Suggestive Words

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2010 CAPL Conference

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Is “Producible” Even a Word?

(Bears paw Gets a Freehold Lease Win)

IT SORT OF SEEMS LIKE IT'S RAINING FREEHOLD LEASE COURT DECISIONS LATELY. This is odd to me, since my standard comment over the years has been to tell clients that we can't really say how a Court would interpret this or that word in a lease since no one in Canada seems to take freehold lease issues to Court. Go figure. Nice to see lawyers finally getting a little bit of work.

The latest example of this trend is the Alberta Court of Queen's Bench decision in *Bears paw Petroleum Ltd. v. EnCana Corporation* (2010 ABQB 225). This is a decision of Justice Terry McMahon released in April 2010 and currently under appeal. The case is a lovely example of what I like to call the “literalist” approach to lease interpretation. I am a really big fan of this approach because it relies on simply interpreting the darn words in the lease and avoids

WRITTEN BY
PAUL NEGENMAN
ENERLAW

wishy washy concepts like the intention of the parties or fairness. The case is also excellent in that it is only 9 pages long.

Very straight forward facts:

- CPR Lease from 1960 with habendum but no shutin well clause
- Production from a couple of oil wells from 1973 to 2003, then all oil wells abandoned
- Two new gas wells spud in 1999, production tested at around 37 and 57 mcf/day
- Gas wells are not tied in
- EnCana issues termination notice in 2005 stating that the wells are not capable of production in paying quantities [standard form letter I guess oops]
- EnCana issues notice to take proceeding on caveat, which starts the court action

Plain Language Approach

The habendum of the lease allows for continuation after the primary term “... so long thereafter as the leased substances or any of them are **producible** from the lease area ...”

The use of the words “are producible” is rather non-standard and so this decision may not apply to a bunch of your leases. However, where you have this wording, you will be happy, since the Court interprets these words in a very lessee friendly way.

The Court very succinctly deals with “producible” as follows:

[25] Producidble does not mean that the product must be able to go to market without anything more to be done. A successful well remains producible in plain language even though the actual flow of gas to market awaits regulatory approval, well-head completion or contractual arrangements with carriers.

[26] When, after a well is drilled, leased substances are found in economic quantities, those substances are capable of being produced when other things are done – that is, they are “producible”.

Wow, there is a lot of stuff tied into these two little paragraphs.

The first major aspect for me is the Courts appeal to the “plain language” interpretation of the word producible. As I said above, I prefer a plain language approach to an intention or fairness approach. We even seem to be getting a bit of traction on this approach if you combine this case with the Court of Appeal decision in *Kensington Energy v. B & G Energy* in 2008.

Don’t get me wrong, I understand that an appeal to “plain language” is an illusion. The illusion of course being that the plain meaning of the word obviously must not have been clear or two grown up oil companies would not bother to fight a lawsuit about what the word means. In short, the plain meaning of a word becomes clear only when a judge tells you so.

Anyway, I guess we all now know that the plain meaning of the words “are producible” means drilled well, plus reserves in the ground capable of being produced, equals producible.

What You Don’t Need to Do

The next interesting aspect of this decision is that it outlines a few things you don’t need to do for a well to be “producible”. Coincidentally, these are many of the same things landmen call me about when they are hoping their leases are still alive.

Not Tied In

Very common is the completed gas well which has been production tested but never tied in. If you have a “producible” lease you are now golden. This has always been a grey area which we qualify in our opinions. I myself have been a bit wishy washy on whether a well needs to be tied in order to continue a “producible”, or more importantly a “capable”, form of lease. Nice to finally have a Court speak to a non tied in well under a freehold lease. Not sure I totally agree that a well can be “producible” without being tied in, but at least the Court’s reasoning makes sense. Methinks this particular issue may be significant on the appeal of this decision.



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Jack Norman, President
Dale Norman, Land Manager

Elexco Land Services, Inc.
Tel: (716) 372-0788
Fax: (716) 372-0515
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Olean, New York
USA 14760
Randall Hansen, CPL, President
Jack Norman, Vice President

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Pending Regulatory Approval

Also common is the complaint that we couldn't get our well license in time or we could not get the other guys to pool. Under the reasoning in this decision, you may now be able to claim that a submitted but not approved well license application or a forced pooling application continues your "producibile" lease past the primary term. This is because such an application may be a "pending regulatory approval" that can continue the lease beyond the primary term. Seems pretty weak to me, but for the producibile form of lease a Court has spoken.

Well Head Completion

The Court even goes so far as to say that leased substances are producibile even if the well is not completed. Tough to go much further than this. Getting pretty close to continuing a lease based on seismic and no well on the lands. Of course I jest, the Court does require a well to be drilled on the lands to continue the lease. But honestly, people still call and insist that if reserves have been booked for the lands, the lease is good. No need for a well. I beg to differ.

Does Producibile Rhyme with Capable?

Remember that this is a rare form of lease. You just don't see the words "are producibile" very often. The real interesting aspect of this decision is wondering out loud if "producibile" is the same as "capable of production" in the shutin clause of the CAPL form of lease.

The Court distances itself from the analogy by stating:

[27] Cited by Bears paw was a decision of the Alberta Energy Conservation Board, *Desoto Resources Ltd.* [2008] CarswellAlta 905 (ERCB), which dealt with the phrase "capable of production in paying quantities". Production in paying quantities was a defined term. Relying on authority, the Board concluded that the phrase did not extend the lease beyond the primary term where previously productive wells had been suspended or abandoned. Again, this language is much different from the language in the lease before me.

Not sure I agree that the words are much different. "Producibile" smells kinda like "capable of production" to me. In fact, Justice McMahon's summary of EnCana's position on what producibile means is pretty darn close to what I think capable of production means. Justice McMahon states that:

[18] It is EnCana's position then that the words "so long thereafter as the leased substances ... are producibile from the leased area" must mean "capable of current and actual production to market", of which the 102/8-23 natural gas well was and is not because it is not tied into a pipeline.

He decides that producibile means something less than "capable of current and actual production". Not sure I agree, and apparently neither does EnCana. This decision is being actively appealed to the Alberta Court of Appeal and should be heard sometime in the late fall.

Capable Goes to Court

So now we have a current case on appeal to the Court of Appeal regarding what "producibile" means. Since "producibile" may or may not mean "capable", this appeal is not too relevant to most of us. It's just too bad that no one is going to the Court of Appeal to decide the plain meaning of the words "capable of producing the leased substances, or any of them".

But wait. The *OMERS Energy Inc. v. Alberta (Energy Resources Conservation Board)*, 2009 ABCA 273 appeal is set to be heard by the Court of Appeal in mid-October 2010. See my December 2009 *Negotiator* Article "Was it Meaningful for You" if you want to see how the ERCB interpreted these words in the CAPL lease. Definitely not a plain language approach. Let's only hope that the Court of Appeal follows a plain language approach to the words and gives us some clear direction on the meaning of the shutin well language in the CAPL lease.

Nice to see that the rain is not letting up. We could be in the enviable position sometime next year where we can actually point to a Court of Appeal decision, or two, in Alberta that defines some pretty fundamental issues about how Courts interpret freehold leases and what some of the key words mean. Stay tuned.

Predictions Anyone?

This article has been written prior to the Court of Appeal hearing in *OMERS* (assuming it goes ahead), but I am going to go out on a limb here and predict what the Court of Appeal will do. Very dangerous thing for a lawyer to do, but I'm bored and not a litigator so why not give er a whirl.

I predict that the Court of Appeal will overturn the ERCB decision that capable means "meaningful" and will instead apply a plain language approach to interpreting the lease. My guess is that "capable" means something like the present and constant ability for leased substances to be produced from the wellbore without the necessity of any further operation or action by the lessee. Not sure if the *OMERS'* wells meet this test, but that is a factual matter, not a legal issue and I do not feel compelled to go out that far on a limb.

Keep in mind that my interpretation above is pretty much what I think producibile means, i.e. I think the Bears paw wells needed to be tied in to be producibile. A judge already thinks I got that one wrong. So please take my prediction with a grain of salt and don't think less of me if I am totally off target. ☹