

ALBERTA ENERGY AND UTILITIES BOARD

IN THE MATTER OF PART 2 OF PROCEEDING NO. 1457147,
COALBED METHANE (CBM) REVIEW HEARING

CENTRICA CANADA LIMITED
REPLY SUBMISSIONS AND AUTHORITIES

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I. INTRODUCTION

1. Centrica Canada Limited (“Centrica”) has reviewed the submissions of Carbon Development Partnership (“CDP”) and EnCana Corporation (“EnCana”) (collectively referred to hereinafter as the “Coal Owners” or “Respondents”). The lack of reply to any particular issue should not be taken as agreement. Centrica reserves the right to make full submissions at the conclusion of this proceeding in respect of the entire hearing record.

2. This reply submission is filed concurrently with the joint reply submission (the “Joint Reply”) that Centrica has filed with ConocoPhillips Canada Resources Corp., Devon Canada Corporation, Fairborne Energy Ltd., Quicksilver Resources Canada Inc. and Canpar Holdings Ltd. (collectively referred to hereinafter as the “Gas Producers” or the “Natural Gas Rights Holders”). Centrica has read and reviewed the reports attached to the Joint Reply and agrees with the analysis and conclusions therein.

II. JURISDICTION OF THE BOARD

3. The contention raised by the Coal Owners that the Board cannot grant well licenses or establish holdings because of the issue of entitlement to Coalbed Methane (“CBM”) is wrong.

**CDP Submission paras. 18, 26, 34 [Exhibit 03-036-2006-09-15];
EnCana Submission paras. 5, 63, 71 [Exhibit 07-024-2006-09-15]**

4. The fact is that in these proceedings:

- (a) The Board must be satisfied that the Applicants are entitled to produce gas;

See section 16(1)(2) of the *Oil and Gas Conservation Act*, R.S.A. 2000, c. O-6 [Exhibit 10-018a-2006-08-25]

- (b) This involves a determination as to whether CBM is gas. The Board has the jurisdiction to make that determination;

See section 1(2) of the *Oil and Gas Conservation Act*, R.S.A. 2000, c. O-6 [Exhibit 10-018a-2006-08-25]; and see section 1(2) of the *Coal Conservation Act*, R.S.A. 2000, c. C-17 [Exhibit 10-018b-2006-08-25]

- (c) The Applicants have established beyond a balance of probabilities that CBM is natural gas; and

(d) The Applicants have established that they are entitled under their respective leases to produce natural gas, therefore, the Board should grant the well licenses and establish the holdings applied for.

5. As submitted, by statutory authority, the Board has the jurisdiction to make the determination that CBM is natural gas. Section 1(2) of the *Oil and Gas Conservation Act*, R.S.A. 2000, c. 0-6 (“*OGC Act*”) provides as follows:

The decision of the Board is final as to whether any product or mixture comes within a definition in subsection (1) or as to whether a definition in subsection (1) is applicable in a particular case.

***Oil and Gas Conservation Act*, R.S.A. 2000, c. O-6 [Exhibit 10-018a-2006-08-25]**

6. Section 1(2) of the *Coal Conservation Act*, R.S.A. 2000, c. C-17 also provides that:

A decision by the Board as to whether a definition in subsection (1) is applicable in a particular case is final.

***Coal Conservation Act*, R.S.A. 2000, c. C-17 [Exhibit 10-018b-2006-08-25]**

7. Subsection 1(1) of the *OGC Act* defines “gas”, “raw gas” and “marketable gas” as follows:

“gas” means raw gas or marketable gas or any constituent of raw gas, condensate, crude bitumen or crude oil that is recovered in processing and that is gaseous at the conditions under which its volume is measured or estimated;

“raw gas” means a mixture containing methane, other paraffinic hydrocarbons, nitrogen, carbon dioxide, hydrogen sulphide, helium and minor impurities, or some of them, that is recovered or is recoverable at a well from an underground reservoir and that is gaseous at the conditions under which its volume is measured or estimated;

“marketable gas” means a mixture mainly of methane originating from raw gas, if necessary through the processing of the raw gas for the removal or partial removal of some constituents, and that meets specification for use as a domestic, commercial or industrial fuel or as an industrial raw material;

***Oil and Gas Conservation Act*, R.S.A. 2000, c. O-6 [Exhibit 10-018a-2006-08-25]**

8. Whereas, subsection 1(1) of the *Coal Conservation Act*, defines “coal” as:

“coal”, in addition to its ordinary meaning, includes manufactured chars, cokes and any manufactured solid coal product used or useful as a reductant or energy source or for conversion into a reductant or energy source;

Coal Conservation Act, R.S.A. 2000, c. C-17 [Exhibit 10-018b-2006-08-25]

9. It is respectfully submitted that CBM comes within the definition of “gas”, “raw gas” and/or “marketable gas” and does not come within the definition of “coal”. Alternatively, it is submitted that “gas”, “raw gas” and/or “marketable gas” is applicable in this case and the definition of “coal” is not.

10. Centrica is not asking the Board to determine ownership. Centrica is simply asking the Board on the basis that it and the other Applicants have established, through their leases, that they have been granted the exclusive right and privilege to explore for, drill for, operate for, produce, win, take remove, store, treat and dispose of natural gas and related hydrocarbons, to grant the Applicants the well licenses and to establish the holdings they have applied for.

Centrica Submission at para. 14 [Exhibit 10-018-2006-08-25]

11. Pursuant to section 94 of the *OGC Act*, “the Board has the exclusive jurisdiction to examine, inquire into, hear and determine all matters and questions arising under this Act.” Furthermore, pursuant to section 16 of the *Energy Resources Conservation Act*, R.S.A. 2000, c. E-10:

The Board, in the performance of the duties and functions imposed on it by this Act and by any other Act, may do all things that are **necessary for or incidental to** the performance of any of those duties or functions. [Emphasis added]

Energy Resources Conservation Act, R.S.A. 2000, c. E-10 [Tab 1]

12. The legislature has given the Board the authority to make a determination that CBM is natural gas and the authority to grant well licenses and establish holdings. If the Board fails to make a determination, it will have undermined its role and will have fettered its discretion.

III. STANDARD OF PROOF AND BURDEN OF PROOF

13. It is well understood that:

The concept of “standard of proof” refers simply to how convinced one must be that a certain fact exists. “Burden of proof” refers to who bears the burden of establishing a fact to that level of satisfaction.

R.W. Macaulay and J.L.H. Sprague, *Hearings Before Administrative Tribunals*, 2d ed. (Toronto: Carswell, 2002) at 17-6 [Tab 2]

14. As provided by section 16 of the *OGC Act*, the standard of proof for a well license is “to the satisfaction of the Board”. The Applicants must prove to the satisfaction of the board, their entitlement to the right to produce the gas.

15. The standard in the within Application is tantamount to the civil burden of “balance of probabilities.”

To the extent that most proceedings before the administrative agencies are civil (as opposed to criminal) in nature, the burden of proof is the civil burden of “balance of probabilities” (as opposed to the criminal standard.

***Hearings Before Administrative Tribunals, supra* at 17-7 [Tab 2]**

***Gannon Bros. Energy Ltd. v. Alberta (Energy & Utilities Board)* 1996 CarswellAlta 56 (Alta. C.A.) [Tab 3]**

16. To suggest that the burden of proof in the within Application should be the criminal standard of “beyond a reasonable doubt” or the “standard of certainty” is incorrect.

CDP Submission paras. 29-30 [Exhibit 03-036-2006-09-15]

17. The burden on the Applicants is to satisfy the Board on a balance of probabilities that they have the right to produce gas. It is undisputed by EnCana and CDP that the Applicants have the right to produce natural gas. The leases of the Applicants have been produced and it is evidenced therein that the Applicants have been granted the rights to produce natural gas. The Applicants have established on the evidence before this Board on and beyond the balance of probabilities that CBM is natural gas and is not coal and the Board has the exclusive jurisdiction to determine that issue. With all due respect, the Applicants have satisfied the burden.

IV. COALBED METHANE IS GAS

18. As described above, the sole issue before the Board is whether CBM is gas. The Applicants submit that it is beyond doubt that CBM is indeed gas.

A. Statutory Definitions

19. The statutory definitions of “gas” and “coal” crystallize the common understanding of these terms in the energy industry. These definitions make a clear distinction between these two substances. These definitions are set out in paragraphs 7 and 8 above.

B. Board Determinations

20. As evidenced in several publications, the Board has already made the determination that CBM is natural gas.

EUB Informational Letter 91-11 re Coalbed Methane Regulation [Exhibit 10-002-1991-08-26]

EUB EnerFAQs No. 10 re Coalbed Methane [Exhibit 10-003-2004-01-01]

Alberta Energy Utilities Board, “Across the Board – Busting the myths behind CBM”, March 2006 [Tab 4]

21. It is submitted that the Board’s determinations accurately reflect the common understanding of the nature of CBM.

C. Language of Granting Instruments

1. Vernacular Meaning

22. The common law rule of interpretation is that the plain, ordinary meaning of the words used is to be adopted in construing a document. The law dictates that the terms “natural gas” and “coal” be given their plain and ordinary meaning, as they were used in the vernacular, when the subject leases were entered into. This principle has been applied to achieve consistent results in consideration of a large number of instruments in a variety of contexts.

Borys v. Canadian Pacific Railway (1953) 2 D.L.R. 65 (JCPC) [Exhibit 10-018d-2006-08-25]

Anderson v. Amoco Canada Oil & Gas 2004 Carswell Alta 941 (SCC) [Exhibit 10-018e-2006-08-25]

Joint Reply – Expert Report of David R. Percy, Q.C. Dean and W.F. Bowker Professor at pages 3-7 [Exhibit 18-002-2006-09-29]

23. The plain and ordinary meaning of “coal” is “a hard black or blackish rock, mainly carbonized plant matter, found in underground seams and used esp. as a fuel”. “Natural gas” is defined as “an inflammable mainly methane gas found in the earth’s crust, not manufactured.”

***The Canadian Oxford Paperback Dictionary* (Ontario: Oxford University Press, 2000) [Exhibit 10-018f-2006-09-25]**

24. The Respondents have obfuscated this straightforward matter in an attempt to show a “*bona fide*” issue by suggesting that further evidence is required to determine the intent of the parties to clarify the meaning of these words in the lease.

25. In fact, no additional evidence is necessary. The definitions of these terms are neither ambiguous, nor in our submission is there anything in the etymology of these words over the last century to refute the general and ordinary notion that coal is a hard-rock solid, and that natural gas is an inflammable substance found in the earth’s crust. One need look no further than the defined terms in Alberta legislation, the Board’s publications, and consideration of these words by the courts, all of which represent the crystallization of their common meaning in the energy industry.

26. In support of EnCana’s argument as to the intent of the parties, EnCana offers numerous examples of historical “knowledge” of methane gas, and an awareness of the “commercial value” thereof.

EnCana Submission paras. 36-47 [Exhibit 07-024-2006-09-15]

27. The historical examples provided do not in any way assist in determining the specific intent of the parties at the time of the grant of lease rights to natural gas and the reservation of coal. Rather, this information serves only to demonstrate that a byproduct of the coalification process, referred to as “firedamp” or “gas”, was produced and utilized. Knowledge and use of a byproduct does not support the argument that the grantor’s intent was to incorporate a separate substance into the reservation in these particular leases.

EnCana Submission para. 58 [Exhibit 07-024-2006-09-15]

28. Centrica notes that the Respondent EnCana’s examples are mainly from Europe. The suggestion that the commercial value of methane gas was known and appreciated is not consistent with the judicial notice taken in Canada of the “mistaken belief [that] natural gas was a worthless and noxious substance,” and in the United States that CBM gas was “a dangerous waste product”. In both cases, the gas was therefore not reserved out of the grants at issue.

Alberta Energy Co. v. Goodwell Petroleum Corp. 2003 Carswell Alta 1394 at para. 34 (Alta. C.A.) [Tab 5]

Amoco Production Company v. Southern Ute Indian Tribe et al. 1999 U.S. Lexis 4002 at page 8 [Tab 6]

29. Moreover, the Respondent's postulation as to the knowledge of the coal industry, in fact, suggests that the intent of the parties was to the grant of rights to coal but *not* to CBM. Coal was reserved from the grant. CBM was known to be distinct substance having economic value but was not specifically reserved from the grant. Simply put, if the coal industry was aware of the existence and commercial value of CBM, then why was this substance not specifically included in the reservation, along with coal, at the time of the grants?

30. In this regard, one must apply the rule of construction of *expression unius est exclusion alterius*, which provides that mention of one thing implies exclusion of another; that is, when certain persons or things are specified in a law, contract, or will, an intention to exclude all others from its operation may be inferred.

Black's Law Dictionary, 6th Edition (U.S.A.: Library of Congress Cataloging -in-Publication Data, 1990) [Tab 7]

31. The reservation of "coal" cannot be read to include CBM because the inclusion of the word "coal" implies the exclusion of other substances. If the grantors indeed had knowledge of methane gas and its commercial value and had intended to reserve this substance, they could have specifically done so in the leases.

32. Furthermore, it is an untenable stretch to suggest that CBM belongs to the Coal Owners because CBM, until recently, had no commercial value to the Natural Gas Rights Holders and that the Board should draw the conclusion that CBM belongs to the Coal Owners because solution gas belongs to petroleum owners. The fact is that natural gas was specifically granted and not specifically reserved, and CBM is natural gas.

EnCana Submissions, paras. 48-49 and 60-61 [Exhibit 07-024-2006-09-1]

2. *Applicable Authorities*

33. The Respondents rely on the *Borys* and *Anderson* decisions to support their proposed interpretation of "coal" as including CBM. These cases set forth general principles of interpretation. However, the specific analyses of the substances in those cases are distinguishable from the present circumstances.

34. In *Borys*, the Court decided that petroleum and natural gas were different substances and that the distinction between them depended upon their state *in situ*, that is, in the reservoir. In *Anderson*, the court held that the petroleum owners were entitled to all hydrocarbons which were in liquid phase in initial pool conditions, irrespective of the phase at the time of recovery.

35. The specific determinations in these cases are distinguishable as there is no issue in this case as to the “phase” of either coal or CBM. Coal is a solid and CBM is natural gas. Neither substance changes its phase or state during the production process.

Expert Opinion of Matthew J. Mavor at page 20 [Exhibit 18-001-2006-08-25]

36. The Respondent EnCana’s reasoning that *Borys* applies because solvation of solution gas in petroleum is the same as the physical bonding mechanism of CBM to coal flies in the face of common sense. The fact that CBM is adsorbed to coal does not make it coal. To apply such reasoning would mean that the right to gas contained in other sedimentary rock, which is also adsorbed thereto, would accrue to the holder of the right to the rock. Under Canadian law, such gas does not belong to the owner of the sedimentary rock. Common sense dictates that CBM should be treated no differently merely because it is adsorbed to the reservoir rock.

EnCana Submissions, paras. 56-57 [Exhibit 07-024-2006-09-1]

37. The Respondents also argue that the reservation of coal should be interpreted to mean the strata *in toto*, based on cases such as *Little v. Western*. This interpretation is erroneous as it is based on case law on the issue of “outstroke”.

38. “Outstroke” is simply the right of a holder of mineral rights to use the workings and tunnels beneath the property to remove minerals from beneath adjacent lands. This concept has nothing to do with the right to remove *other minerals* not owned by the holder.

39. The concept of outstroke cannot logically be applied to the present case as it does not deal with the question of ownership of the subsurface; rather, it is limited to the *right to the use* of the subsurface. Further, the cases that consider outstroke do not involve either the right to remove different minerals from the same strata as the coal, nor do they “purport to resolve competing claims to minerals other than coal found in those strata.”

Joint Reply – Expert Report of David R. Percy, Q.C. Dean and W.F. Bowker Professor at pages 14-16 [Exhibit 18-002-2006-09-29]

40. Thus, the proposition that the Respondents are entitled to all mineral rights within the strata by virtue of the wording of the lease is unsupported by the law. Moreover, to stretch this concept to apply to the present circumstances would be absurd.

41. The current state of the law is that there is no Canadian authority that deals with the precise issue of whether CBM belongs to owners of coal or owners of natural gas. The most important decision in the common law world on competing ownership claims to CBM is the United States Supreme Court decision of *Southern Ute Indian Tribe*, *supra* [Tab 6].

Joint Reply – Expert Report of David R. Percy, Q.C. Dean and W.F. Bowker Professor at pages 14, 18-19 [Exhibit 18-002-2006-09-29]

42. In *Southern Ute*, the Court reviewed a grant containing a reservation of “all coal in the said lands and the right to prospect for, mine and remove the same.” At issue was whether this reservation included CBM.

***Southern Ute Indian Tribe*, *supra* at page 2 [Tab 7]**

43. In considering the wording of the grant, the Court unequivocally concluded that the common understanding of coal in the early part of the twentieth century would not have included CBM because it is a gas rather than a solid. The Court found that at that time, it was understood that CBM was a “distinct substance” that escaped from coal, rather than part of the coal itself.

***Southern Ute Indian Tribe*, *supra* at page 3 [Tab 7]**

44. The *Southern Ute* case is persuasive authority because, *inter alia*, it adopts an interpretive approach akin to *Borys*, and because the type of reservation considered in this case is similar to those used in Western Canada.

Joint Reply – Expert Report of David R. Percy, Q.C. Dean and W.F. Bowker Professor at pages 18-22 [Exhibit 18-002-2006-09-29]

3. *CBM is natural gas*

45. It is respectfully submitted that the statutory definitions, EUB determinations, the vernacular meaning and the applicable case law demonstrate on or beyond the balance of probabilities that CBM is natural gas. If there is any lingering doubt after review of the foregoing, one need only look to the scientific and technical evidence of Matthew J. Mavor, (the “Mavor Report”) which evidence is compelling.

Expert Opinion of Matthew J. Mavor [Exhibit 18-001-2006-08-25]

46. The Mavor Report resolutely confirms that CBM is natural gas:

- Coal and CBM are distinct and differ from one another both on the surface after extraction from the ground and in the subsurface before and after disturbance by man;
- CBM is a natural gas that can be produced from coal seams. CBM is indistinguishable from natural gas produced from sandstone, siltstone, shale, carbonate, or other rock types in both composition and economic value;
- Coal is a rock that serves as the container for storage of CBM both before and after the reservoir has been disturbed by man;
- From a reservoir engineering standpoint CBM shares very similar flow characteristics through coal seams as natural gas flow through other rock types.

Expert Opinion of Matthew J. Mavor at page 2 [Exhibit 18-001-2006-08-25]

47. The expert evidence Mr. Levine tendered by the Respondents is not persuasive as several of his postulations are not supportable or are internally inconsistent, for example, *inter alia*:

- Mr. Levine's statement that "coal may not be described as a solid in the sense of the word that describes a phase of matter distinct from a liquid or gas" is not supported by common sense or generally accepted scientific beliefs, and furthermore, contradicts other statements made in his report;

Expert Opinion of Jeffery R. Levine at page 41 [Exhibit 19-002-2006-09-15]

Joint Reply – Expert Opinion of Matthew J. Mavor in Reply at pages 1-2 [Exhibit 18-002-2006-09-26]

- Mr. Levine's statement that "physical chemical forces between methane and other coal constituents cause methane to condensate into a liquid-like form" is contrary to current theories concerning methane adsorption isotherm behaviour. These theories are based upon physical adsorption due to weak intermolecular magnetic forces, not due to strong chemical forces;

Expert Opinion of Jeffery R. Levine at page 1 [Exhibit 19-002-2006-09-15]

Joint Reply – Expert Opinion of Matthew J. Mavor in Reply at pages 3-4 [Exhibit 18-002-2006-09-26]

- Mr. Levine states: “[a]s free molecules such as methane, water and oil are dispersed throughout the organic structure of the coal, it makes little sense from a compositional standpoint to identify certain components of this system as representing ‘coal’ and other components as something other than coal. ...” This view differs from and is not supported by the vast majority of technical practitioners in the petroleum industry, who commonly differentiate between mobile and immobile fluid phases and rock from various viewpoints.

Expert Opinion of Jeffery R. Levine at page 25-26 [Exhibit 19-002-2006-09-15]

Joint Reply – Expert Opinion of Matthew J. Mavor in Reply at page 1 [Exhibit 18-002-2006-09-26]

- Mr. Levine states: “[m]oreover, the presence of methane changes the physical structure of coal, which swells in the presence of methane and shrinks if the methane is lost.” This statement is misleading. The changes to the physical structure of coal due to the presence of methane are nominal, 1% or less.

Expert Opinion of Jeffery R. Levine at page 1 [Exhibit 19-002-2006-09-15]

Joint Reply – Expert Opinion of Matthew J. Mavor in Reply at pages 4-5 [Exhibit 18-002-2006-09-26]

48. The theories of Mr. Levine, as pointed out by Mr. Mavor, do not reflect the views of the vast majority of technical practitioners in the petroleum engineering community. It is submitted that the arguments of EnCana and CDP that CBM is coal and not gas are an untenable stretch.

V. INDUSTRY PRACTICALITIES AND REALTIES

49. Centrica supports in full the arguments of the other Natural Gas Rights Holders presented in respect of “compulsory pooling” and “Reducing DSUs”.

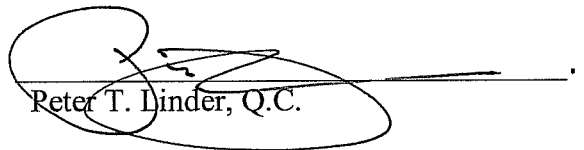
VI. CONCLUSION

50. It is submitted that the foregoing overwhelmingly establishes that CBM is natural gas and that it is within the Board's jurisdiction to make that determination. The Applicants have sufficiently demonstrated to the Board that they are entitled to produce natural gas. In the result, the Applicants submit that the Board must grant the well licences and establish the holdings applied for.

ALL OF WHICH IS RESPECTFULLY SUBMITTED, this 29th day of September, 2006.

PEACOCK LINDER & HALT LLP

Per:



Peter T. Linder, Q.C.

Solicitors for Centrica Canada Limited

LIST OF AUTHORITIES

1. *Energy Resources Conservation Act*, R.S.A. 2000, c.E-10
2. R.W. Macaulay and J.L.H. Sprague, "*Hearings Before Administrative Tribunals*", 2d ed. (Toronto: Carswell, 2002) at 17-6
3. *Gannon Bros. Energy Ltd. v. Alberta (Energy & Utilities Board)* 1996 CarswellAlta 56 (Alta. C.A.)
4. Alberta Energy and Utilities Board, "*Across the Board - Busting the myths behind CBM*", March 2006
5. *Alberta Energy Co. v. Goodwell Petroleum Corp.* 2003 CarswellAlta 1394 at para. 34 (Alta. C.A.)
6. *Amoco Production Company v. Southern Ute Indian Tribe et al.* 1999 U.S. Lexis 4002
7. *Black's Law Dictionary*, 6th Edition (U.S.A.: Library of Congress Cataloging-in-Publication Data, 1990)