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Our File: 10451 006 CJP

Alberta Energy & Utilities Board
640 -- 5 Avenue S.W
Calgary, Alberta
T2P 3G4

Attention: Carla Giesbrecht

Dear Madam:

Re: EUB Applications No. 1379726, et al.
Category and Type: B140
Application for CBM Well Licences – Wimborne Field

This letter is to provide EnCana's response to Devon's 21 March 2005 submission by counsel in the captioned matter, made on your 28 March invitation.

EnCana has an interest in eight quarter sections of land relevant to this matter, all of which are within sections 15 and 35 of townships 34 and 33 (respectively) of range 26, west of the fourth meridian

For seven of those parcels, EnCana is the successor as lessor under petroleum and natural gas leases (the "Leases") For the eighth parcel, EnCana is successor to a transferor which reserved coal, petroleum and valuable stone (the "Transfer") and lessor of that petroleum.¹

Devon, apparently as successor as lessee on all eight parcels, seeks your approval of four well licences on each section for "sweet coaled methane", claiming its "entitlement to produce natural gas establishes a *prima facie* entitlement to the licences".²

However, Devon has no express or implied entitlement to produce coalbed methane (CBM) as claimed; and if Devon means to suggest a *prima facie* right is sufficient for the approval sought, it is in error

¹ P&NG Leases, dated variously, and Land Titles Certificates [Tab 1] Note that EnCana's records do not accord with the records noted in Devon's Schedules purportedly summarizing the relevant title documents

² Devon Applications, Sheets Entitled "General Information"

Devon Must Have Ownership of or an Entitlement to Produce the CBM

It is axiomatic that Devon, by the *Oil and Gas Conservation Act*, must have ownership of the substance to be recovered prior to obtaining the approval for recovery sought.

4. The purposes of this Act are:

(d) to afford each owner the opportunity of obtaining the owner's share of the production of oil or gas from any pool;

16(1) No person shall apply for or hold a licence for a well

(a) for the recovery of oil, gas or crude bitumen, or

(b) for any other authorized purpose

unless that person is a working interest participant and is entitled to the right to produce the oil, gas or crude bitumen from the well or the right to drill or operate the well for the other authorized purpose, as the case may be.³

Devon has no such ownership or entitlement to produce CBM by express grant, and seeks an interpretation of the Leases and the Transfer contrary to law and the intent of the contracting parties.

Insofar as Devon suggests a right to produce natural gas establishes a *prima facie* entitlement to the well licences requested, it misapprehends the legislation. Devon must have ownership of the CBM and an entitlement to produce it.

And to the extent Devon suggests, as it apparently does, that a *prima facie* case for entitlement is sufficient, it is in error. The purpose of the statute is to afford owners their share of production and requires that applicants be "entitled to the right" – without qualification – and the onus is on Devon as lessee and applicant to prove its entitlement.⁴

The issue here is not whether CBM is natural gas (which is the tenor of Devon's submission) but whether the Leases and the Transfer grant to Devon the right to drill into and work EnCana's coal seams to produce CBM. EnCana submits that Devon has no such right under the Leases and the Transfer.

Devon is in Default and has no Entitlement to a Well Licence for Sec. 35

Devon, by the Leases, covenanted that in the event of commercial production of petroleum or natural gas from any well on a drilling unit laterally adjoining the leased area and not owned

³ *Oil and Gas Conservation Act*, RSA 2000, c 0-6 [Tab 2]

⁴ See *Freyberg v Fletcher Challenge Oil & Gas Inc*, 2005 ABCA 46, at paras 74-83 [Tab 3]

by the lessor, it would commence the drilling of an offset well on the leased area within ten days after the well to be offset has produced petroleum or natural gas (clause 12).

Notwithstanding that petroleum or natural gas has been produced from a well on adjoining lands, Devon has not drilled an offset well as required. Devon is in default of the Leases pertaining to Sec 35.

Devon has been provided written notice requiring it to remedy its default.⁵ If Devon does not remedy the default within 60 days, as required by the Leases, EnCana may enter into and upon the lands to repossess them (clause 17).

EnCana submits that the EUB should not consider the well licence application for Sec. 35 until Devon's default is rectified.

Devon Has No Entitlement to Produce CBM

A. Devon Has No Express Entitlement to Produce CBM from EnCana's Coal

The Leases grant:

All the petroleum and natural gas, natural gasoline and related hydrocarbons other than coal and also including sulphur as recovered in solution or in association with any of the liquid or gaseous hydrocarbons.

The Transfer reserves "coal, petroleum and valuable stone."⁶

CBM was not expressly granted to Devon by the leases and coal was reserved by the Transfer. And CBM is not natural gas, contrary to the submissions of Devon.

The Supreme Court of Canada in *Anderson v. Amoco* confirmed the principle (established in *Borys v. CPR*⁷) that when construing a grant or reservation of mineral rights, the vernacular meaning of the words in the grant or reservation as of the time of the transfer is to be used.⁸

By that principle, Devon's submission that CBM is natural gas because both are largely methane cannot be accepted. Such an interpretation based upon the chemical composition of the substance is contrary to *Anderson v. Amoco*, which requires a determination of the substance *in situ* at the time of the grant prior to human intervention.

The error in Devon's interpretation by chemical composition is evident by its application to the reservation in the Transfer here of "all coal, petroleum and valuable stone", the very

⁵ Notice of Default [Tab 4]

⁶ See Tab 1, for the Leases and Title, showing the reservation (at 1(a))

⁷ [1953] 2 DLR 65 (PC) [Tab 5]

⁸ *Anderson v. Amoco Canada Oil & Gas*, 2004 SCC 49, at para 24 [Tab 6]

reservation interpreted by the Privy Council in *Borys v CPR*⁹ If Devon's submission is correct, "petroleum" is to be interpreted as it was by the Privy Council – *in situ* and in the vernacular – but "coal" in the very same reservation would be defined by its chemical composition.

B. The Reservations of Coal Effect a Substance Severance or a Stratigraphic Severance of CBM in Favour of the Coal Owner.

CBM is present in all coalbeds and results from the biochemical and physical processes extant during the conversion of accumulated plant material into coal. The gas found in coalbeds is generated *in situ* rather than having migrated from other sources.¹⁰

CBM is stored in coal as an adsorbed component on or within the coal matrix, and as a free gas within the micropore structure or cleats within the coalbed.¹¹ While the CBM may migrate to the surface, or into an adjacent reservoir, ninety percent or more of the CBM retained by the coal is thought to be adsorbed or absorbed within coal micropores.¹²

The coal and CBM are most closely related to each other, and much more closely than are conventional natural gas and the formations in which it is found.¹³ Coal and CBM are formed during the same processes, forming a unique bond between the two.¹⁴

Coal cannot be removed from the ground without also removing the CBM. Therefore, a grant or reservation of coal "logically carries with it not only the incidental rights of access and development discussed above but also title to all the coalbed methane in the coal".¹⁵ As the Alberta Court of Appeal said in *Little v. Western Transfer & Storage*, the owner of rights to coal is the owner of the stratum or strata in which the coal is embedded¹⁶, unless a contrary intention is expressed

By the nature of CBM, by reason of its adsorption to the coal, and by its inclusion therefore in the coal's strata, CBM remains with the coal owner in the Leases and in the Transfer. As a result of the decisions in *Borys* and in *Little*, an exclusion and reservation of the coal in the Leases and in the Transfer here effects either a substance severance that includes the CBM produced from the coal or a stratigraphic severance of the coal strata that includes all substances contained therein.

⁹ Transfer of Land from CPR to Borys, 17 January 1918 [Tab 7]

¹⁰ See: *Amoco Production Co. v Southern Ute Indian Tribe*, 526 U.S. 865, 875 (USSC); Schumacher and Baldwin, *Development on Indian Lands, Development Potential, Ownership Rights, and Ownership Issues* (1992) 3 Rocky Mountain Mineral Law Foundation Mineral Law Series 3-9 [Tabs 8 & 9]

¹¹ EUB/AGS Earth Sciences Report 2003-03, *Production Potential of Coalbed Methane Resources in Alberta*, p.5 [Tab 10]

¹² Schumacher, p 3-8 [Tab 9]

¹³ Conrad P. Armbricht, *Multi Mineral Development Conflicts – Coalbed Methane in the Balance* (1992) 3 Rocky Mountain Mineral Law Foundation Mineral Law Service 4B-1 (33) [Tab 11]

¹⁴ *Ibid*, 4B-15

¹⁵ *Ibid*, p 4B-17

¹⁶ *Little v Western Transfer & Storage Ltd*, [1922] 3 WWR 356 (Alta SC, AD), para 22 [Tab 12]

C. An Entitlement of Devon to Produce CBM from EnCana's Coal
Was Not Intended by the Parties

As there is no express grant in the Leases or in the Transfer to Devon of an entitlement to produce CBM from EnCana's coal, Devon has such an entitlement only if it can be implied that the parties so intended. But the parties to those grants (or reservation) had no such intention.

"Natural Gas" does not by implication include CBM. A term cannot be implied into a contract unless it is both necessary and reasonable. Here, the term is neither necessary nor reasonable, and such an implication would be contrary to the parties' intentions. The grants have effect without the desired implication: Devon can produce oil and conventional natural gas.

As at the time of the Leases in 1957 and 1962 and the Transfer (prior to 1920), CBM was largely valueless and had an attendant responsibility because of its danger. The parties would not have intended granting CBM from the coal owner to the oil and gas lessee, or transferring that gas from the coal owner to the settler (who here received the land by the Transfer).

First, CBM had no commercial value in 1920 or 1957/1962. Exploration activity for CBM in Alberta did not commence until the late 1980's and early 1990's¹⁷

Second, in 1957/1962 the owner of a coal mine was obligated to provide adequate ventilation to dilute and render harmless all noxious or inflammable gasses and to make the mine fit for working or travelling.¹⁸ That the owner would convey the very gas that it was obligated to vent is irrational, as the owner would have no entitlement to vent it and would be *subject to claims by the party owning that CBM*.

Third, the industry has only recently drawn a distinction between coal and CBM, for limited purposes. For example, as of 2000, a Crown coal lease granted the right to the coal that is the property of the Crown without further limitation; as of 2004, a coal lease grants the right to the coal that is the property of the Crown in the location but it "does not grant any rights to any natural gas, including CBM".¹⁹

Fourth, working up the coal by fracturing so as to recover CBM may render the coal less valuable to EnCana

D. American Authorities

Reference may be made in this context to American authorities which consider similar facts in light of rules of interpretation akin to those applicable here.

¹⁷ EUB/AGS Earth Sciences Report 2003 03, p 1 [Tab 10]

¹⁸ *Coal Mines Act*, RSA 1955, c 47, ss 412 and 283 [Tab 13]

¹⁹ *Mines and Minerals Act*, RSA 2000, c M-17, s 67; 2003, c 18, s 15 [Tab 14]

In *US Steel Corp v Hoge*²⁰, the lessee of oil and gas rights began drilling a well on one tract of the land for the express purpose of recovering CBM contained in a subjacent coal seam. The lessor, who had the mining rights (including the right of ventilation) sought an injunction to prevent the oil and gas lessee from drilling into and producing from the coal seam and sought a finding that it held title to the CBM.

The Supreme Court of Pennsylvania determined that title to the CBM should be given to the coal owner. It reviewed the characteristics, origins and history of development, and the legal principles related to the ownership of gas. It looked at the language of the conveyance in its entirety and in light of conditions existing at the time of execution – as required here – to give effect to the intention of the parties. The court found that:

This is a general rule, subterranean gas is owned by whoever has title to the property in which the gas is resting. . . . Such gas as is present in coal must necessarily belong to the owner of the coal, so long as it remains within his property and subject to his exclusive dominion and control.

The court found it inconceivable that the parties intended all gas be reserved to the grantor of the gas rights notwithstanding the use of the unrestricted term "gas". It would have strained credulity to believe that the grantor of the coal rights would retain the right to valueless gas with the attendant responsibility for its dangerous nature.

The decision of the Supreme Court of Appeals of West Virginia in *Energy Development v. Moss* is also instructive, given its factual similarities to the matter here. There, the court considered a standard oil and gas lease granted by a coal and surface rights owner.²¹ The court found that the lease did not give the oil and gas lessee the right to drill into the lessor's coal seams to produce CBM. It held that oil and gas leases should be liberally construed in favour of the lessor. It found that commercial CBM wells were not contemplated by the parties at the time, so absent language expressing a clear intention to the contrary, the oil and gas lease did not give the right to produce gas from coal seams retained by the lessor. Production of CBM would permit the lessee to stimulate and invade the coal seams of the lessor in a manner that could make it more difficult and dangerous to later develop the coal.

Submission

It is submitted that Devon is not entitled to the well applications sought, as it has no entitlement to CBM under the Leases or the Transfer.

Devon's application and submission are brazen and presumptuous. Devon suggests that it need only assert a right -- a right which here is not expressly provided for -- and receive

²⁰ 468 A 2d 1380 (1983 Penn S C) [Tab 15]

²¹ *Energy Dev Corp v Moss*, 2003 214 W Va 577 (Supreme Court of Appeals of West Virginia) [Tab 16]

thereby the entitlement to drill through and work EnCana's coal for a substance EnCana says Devon has no right to.

EnCana urges this Board to reject Devon's application, or in the alternative, refrain from granting an approval pending a judicial determination of entitlement.

Yours truly,

Christian J Popowich

CJP/kgw

cc: A.L. McLarty
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