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June 24, 2005

Alberta Energy and Utilities Board
640 - 5 Avenue, SW
Calgary, AB
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Attention: Ms. Giuseppa Bentivegna

Dear Madam:

Re: Devon Canada Corporation ("Devon")
EUB Applications No. 1379726 et al
Applications for Well Licences and
EUB Application No. 1377141
Application to Establish a Holding
Decision dated May 26, 2005
Application for Review and Variance and Application for a Hearing



We are in receipt of your letter of May 26, 2005 (the "Devon Decision") on behalf of the Alberta Energy and Utilities Board (the "Board") respecting the captioned applications by Devon to produce coalbed methane ("CBM") (also known as natural gas from coal or "NGC") from the proposed wells subject to the captioned applications (the "Devon Applications").

Luscar Ltd. ("Luscar") hereby formally makes application to the Board pursuant to Section 46(1) of the Board's Rules of Practice (the "Rules of Practice") for review and variance of the Devon Decision. The order applied for would be issued pursuant to Section 39 of the *Energy Resources Conservation Act* (RSA 2000, c. E-10, as amended) (the "ERC Act").

The Devon Decision was issued by the Board without the conduct of a hearing into the matter. Luscar hereby formally makes application to the Board pursuant to Section 40(1) of the ERC Act for a hearing in respect of the Devon Applications.

Facts Relevant to the Applications

1. As the Board has previously been advised, Luscar is the owner of the coal underlying Sections 8, 9 and 17 in Township 34, Range 26, West of the 4th Meridian.

2. Entitlement to CBM as a produced substance is in dispute in the present circumstances. At page 4 of the Devon Decision, the Board stated:

“Devon acknowledges the potential for claims to be advanced by the owners of the coal estate with respect to the ownership of the gas in coal.”

3. It is common ground between Devon and Luscar that the Canadian courts have not ruled on the ownership and entitlement to produce freehold CBM in Alberta. Consequently, neither Devon nor Luscar can demonstrate undisputed entitlement to produce the CBM at issue in this case.
4. It is further common ground between Devon and Luscar that when the Canadian courts do ultimately quiet the title as to CBM in the hands of either the natural gas owner or the coal owner, at least one of the key and relevant considerations will be the intention of the parties (the transferor and the transferee) at the time title between the natural gas and the coal owner was split. There is no evidence before the Board, whatsoever, as to the intention of those parties at the relevant time.
5. Contrary to the Board’s recommendation and the explicit expectation contained in Guide 65 (at page 4, under the heading “Objections/Dispute Resolution”), Devon has not attempted to negotiate any settlement with Luscar. Further, contrary to its obligations pursuant to Guide 56, Devon has failed to consult with Luscar in any attempt to resolve the outstanding issues between the corporations.
6. Luscar is not attempting to forestall exploration and development of CBM on Luscar’s lands, without any prospect of resolution. Luscar is willing to negotiate a reasonable commercial settlement with Devon.

Grounds on which Applications are Made

7. Luscar’s submissions to the Board in connection with the Devon Applications have, to date, been largely restricted to the lack of jurisdiction of the Board to determine property rights between Devon and Luscar and the failure by Devon to meet the mandatory statutory test of entitlement under the legislation.
8. Luscar understands that the CBM ownership dispute is a difficult one, which will ultimately require at least one decision from the courts to resolve. However, Luscar must rely upon the Board to ensure fairness to both Devon, as applicant and to Luscar, as intervener. In that regard, Luscar has, at all times, reasonably expected that the Board would follow its usual and normal practice in circumstances in which an applicant fails to obtain notices of non-objection to its applications and hold a hearing of the Devon Applications. Luscar reasonably anticipated that it would, at such hearing, be given the opportunity to present evidence as to prejudice it would suffer and the harm which the granting of the Devon Applications would occasion upon Luscar’s property rights. By issuing the Devon Decision without holding a hearing, the Board has unfairly deprived Luscar of the opportunity to present such evidence. With respect, representations of outside counsel do not constitute evidence.

9. Having stated, at page 4 of the Devon Decision, that the Board was of the view that it did not need to determine the issue of mineral ownership of CBM for the Devon Applications (both for the well licences and for the single holding), the Board has, *de facto*, made just such a determination in favour of Devon, by virtue of its finding that the leases filed by Devon “*demonstrate sufficiently Devon’s entitlement to produce all natural gas from the wells and zones it applied for*” (Devon Decision, p. 5). Embedded within this conclusion are three implicit assumptions:
- (a) that CBM is natural gas for all purposes;
 - (b) that the natural gas owner owned the CBM and had all entitlement to produce it; and
 - (c) that, assuming (b), Devon’s leases conveyed the right to Devon to produce CBM.

The Board may or may not have the jurisdiction to review and interpret lease documents in the pursuit of its conservation mandate in order to justify assumption (c). However, with respect, Luscar asserts that the Board has erred:

- (i) by drawing the conclusions identified as assumptions (a) and (b) in the absence of definitive judicial authority as to the nature of CBM as natural gas or of natural gas owner’s ownership of and entitlement to produce CBM; and
 - (ii) further, by drawing those conclusions (or making those assumptions) in the absence of any evidence, whatsoever, as to the intention of the parties to the transactions at the relevant time of the splitting of the natural gas and coal titles.
10. Luscar respectfully asserts that the Board misconstrued Luscar’s submissions by concluding that Luscar has not objected to the Devon Applications on the basis of equity issues. (Devon Decision, p. 5) Disputed ownership of the underlying natural resource and the right (or lack of right) to produce that resource is an issue of both legal rights and of equity as between Devon (and its lessor) and Luscar. One of the stated objects of the *Oil and Gas Conservation Act* (RSA 2000, c. O-6, as amended) (the “O&G Conservation Act”) is:

“to afford each owner the opportunity of obtaining the owner’s share of the production of oil or gas from any pool”. (O&G Conservation Act, s. 4(d))

The Board’s decision prejudices Luscar’s rights as an owner and, by doing so, deprives Luscar of the opportunity to obtain its share of production of CBM from the subject lands, should it be successful in any court action.

Further, at page 2, Guide 65 identifies “equity” in relation to special spacing applications (such as a holding application) as one of the matters expressly addressed in Guide 65. Section 1.6.1 of Guide 65 states, in part:

“The EUB has authority under the Oil and Gas Conservation Act (the Act) to designate drilling spacing units (DSU) and target areas and to make or amend regulations pertaining to them. DSUs are designed to promote efficient reservoir management, protect the correlative rights of the respective mineral rights owners, and aid in resolving conflicts with surface operations where well site location is an issue.” (emphasis added)

Luscar submits that the protection of Luscar’s correlative rights as one of the respective mineral rights owners ought to have been taken into account and was improperly characterized in the Devon Decision as not being an equity issue between competing mineral rights owners.

11. Luscar submits in relation to Devon’s application for a holding that the uncertainty arising from disputed ownership of CBM precludes and precluded Devon from fulfilling the requirements of the *Oil and Gas Conservation Regulations* (AR 151/71, as amended) (the “Conservation Regulations”).

Section 5.005(2) of the Conservation Regulations states:

*“(2) No well shall be produced **unless there is common ownership throughout the drilling spacing unit.**”*

(emphasis added)

Section 5.200 of the Conservation Regulations states:

*“5.200 A holding **shall contain only***

(a) a single drilling spacing unit, or

*(b) whole, contiguous drilling spacing **units of common ownership.**”*

(emphasis added)

Common ownership is defined in Section 1.020(2)4. of the Conservation Regulations as follows:

“4. “common ownership”, when that term is used in connection with a block, holding or project, means that

*(i) **the ownership of the lessors’ interests throughout the block, holding or project is the same and the ownership of the lessees’ interests throughout the block, holding or project is the same, or***

*(ii) **the owners of the lessor’s interests and the lessee’s interests throughout the block, holding or project have agreed to pool their interests;”.***

(emphasis added)

The use of the word “shall” in these sections invokes a mandatory obligation. Luscar disputes the ownership of the natural gas owner (natural gas lessor) to the CBM underlying and within these lands. The ownership of the lessors’ interests throughout the proposed holding is not the same. Consequently, in the absence of a definitive court ruling in favour of the natural gas owner, Devon could not and did not demonstrate that there is common ownership throughout Devon’s proposed holding and Devon was therefore not entitled to a holding order from the Board. In light of the mandatory language used in the relevant enabling legislation, Luscar asserts that the Board erred in issuing a holding order to Devon as part of the Devon Decision, again in the absence of a definitive judicial determination as to ownership of CBM.

The other alternative available to Devon to demonstrate “common ownership” would have been to prove to the Board that all owners of the lessors’ interests and the lessee’s interests throughout the holding have agreed to pool their interests. Devon has not requested that Luscar (nor has Luscar agreed to) pool its lessor’s interest in CBM underlying these lands with Devon or with any other person. Consequently, Devon could not establish such a pooling and thereby avail itself of the benefit of “common ownership”.

Luscar asserts that the Board erred by granting Devon’s application for a holding in circumstances in which Devon did not, and Luscar submits could not, fulfil the statutory requirements for a holding application.

Nature of Prejudice or Damage

12. Should Luscar be successful in its action to quiet its title to CBM, then Luscar will have suffered a loss of property rights as to the appropriate pace, methodology, operations and development of its CBM resource. The Devon Decision renders moot any future exercise by Luscar of these property rights.
13. Further, and Luscar submits more fundamentally important, had the Board held a hearing of the Devon Applications, Luscar would have adduced evidence as to the difficulty, if not the impossibility, of demonstrating what percentage of such production constituted CBM, in the event of commingling of conventional natural gas with CBM. This evidence is relevant. Should Luscar ultimately be successful in an action to quiet title then, coupled with a declaration by the court of Luscar’s ownership and entitlement to CBM, Luscar will be required to prove damages suffered by Devon’s wrongful appropriation of Luscar’s CBM. The Devon Decision could well render any court success by Luscar a hollow victory. As a consequence, Luscar must rely upon the Board not to tip the scales in favour of Devon to the detriment of Luscar. Luscar seeks variance of the Devon Decision to ensure that Luscar is not unfairly prejudiced in its court action to quiet title. Luscar requests that the Board condition the Devon Decision to prohibit commingled production of CBM with conventional natural gas from any zones and to require:
 - (a) that all wells drilled by Devon be dually equipped for the separated production of CBM from conventional natural gas;

- (b) that all wells be equipped with separate metering facilities for the measurement of CBM from conventional natural gas and that such metering facilities be used on an ongoing basis; and
- (c) that Devon be required to report to the Board CBM production from each well separately from conventional gas production.

Dual completion and separate metering will not impose undue hardship on Devon or cause Devon prejudice. It is Luscar's understanding that the incremental cost of a packer and extra metering to allow dual completion in the dry coals (such as the Horseshoe Canyon) is approximately \$30,000 to \$35,000 per well. This is not a significant increase on wells which cost in the order of \$250,000 to \$300,000 to drill and complete.

Luscar notes that the Board presently requires producers to separately designate CBM wells from conventional natural gas wells, for the purpose of facilitating aggregate well and production data in Alberta. Luscar believes that the foregoing conditions requested to be imposed by the Board will also contribute to more accurate data collection by the Board for its own purposes.

- 14. There is a risk that Devon may not be sufficiently solvent to allow Luscar to recover damages in the event of successful court action. As it presently stands, the Devon Decision does nothing to alleviate this risk. This unfairly places this risk on an innocent party, Luscar, rather than on Devon, which is the party who insists upon proceeding with its plans to develop CBM in the face of a clear and unequivocal contrary claim to entitlement.

Remedies Sought

- 15. Luscar seeks, upon the review and variance of the Devon Decision, an order of the Board staying or suspending the execution of the Devon Decision, pending the issuance of a final, unappealable decision of the court as to Devon's entitlement to produce CBM from the lands in which Luscar owns the coal rights and which lands are the subject of the Devon Applications.
- 16. If the Board is unwilling to grant such an order, Luscar seeks variance of the Devon Decision, such that the Board condition all well licences and the holding order as described in paragraph 13 above.
- 17. In circumstances in which there is a dispute over entitlement to receive production and in which the Board has issued an order pursuant to Part 12 of the O&G Conservation Act, Section 86(1) of that statute ("Section 86(1)") expressly provides:

"86(1) If a dispute arises as to the person entitled to receive the production allocated to a tract in accordance with an order of the Board made pursuant to this Part, the operator or unit operator

- (a) *shall sell the production with respect to which the dispute has arisen,*
- (b) *may pay out of the proceeds of sale the costs and expenses payable with respect to the tract, and*
- (c) *shall pay the balance of the proceeds to the Provincial Treasurer to be held by the Provincial Treasurer in trust pending an order of the Court of Queen's Bench or until a settlement has been reached by the parties."*

This remedy has been acknowledged by the Alberta Court of Appeal in the case of *Alberta Energy Company Ltd. v. Goodwell Petroleum Corporation and The Alberta Energy and Utilities Board*, (2003 ABCA 277 (Alta CA)), in which Madame Justice Fruman stated, at page 28:

"Disagreements about production frequently occur, and are even recognized in the energy legislation"⁴²,

Footnote 42 on page 28 references Section 86(1) with the positive assessment that, in those cases, "[t]he well is not shut in, nor are the parties' underlying rights affected".

Luscar acknowledges that the Devon Decision is not an order made pursuant to Part 12 of the O&G Conservation Act. However, the Board has general power pursuant to Section 7 of the O&G Conservation Act, with the approval of the Lieutenant Governor in Council, pursuant to which the Board

"may make any just and reasonable orders and directions the Board considers necessary to effect the purposes of this Act and that are not otherwise specifically authorized by this Act".

18. In the event that the Board is unwilling to stay or suspend the Devon Decision, as requested above, Luscar seeks an order of the Board pursuant to Section 7 of the O&G Conservation Act on terms and conditions substantially the same as those contained in Section 86(1) requiring the placing of net proceeds of production of CBM either with the Provincial Treasurer or into Court. In that regard, Luscar acknowledges that the costs of drilling and completing the wells (including any extra equipment required to comply with the requested conditions) should be considered in determining "net proceeds". Luscar respectfully submits that such an order is just and reasonable in the present circumstances to ensure fair and equitable treatment both to Devon and to Luscar. Luscar further submits that such an order would be in the public interest by enabling natural gas producers or coal owners who wish to develop CBM reserves in advance of a definitive court ruling to do so, while not prejudicing the owner of either the coal or the natural gas disputing the proposing producer's right to that CBM resource. To paraphrase Fruman, J., development is not forestalled, nor are the parties' underlying rights affected.

19. In respect of its application pursuant to Section 40(1) of the ERC Act, Luscar seeks a hearing of the Devon Applications.

Address for Service

20. The address for service of notices to Luscar is as set out at the top of this letter.

Please also send copies of all correspondence to:

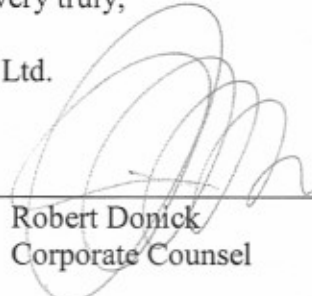
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All of which is respectfully submitted.

Yours very truly,

Luscar Ltd.

Per:



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