

Via Email

May 25, 2016

Dentons Canada LLP

Gowling WLG

Calgary Head Office
Suite 1000, 250 – 5 Street SW
Calgary, Alberta T2P 0R4
Canada

Attention: Dennis P. Langen and
Agnes Bielecki

Attention: John R. Cusano

www.aer.ca

Dear Sirs and Madam:

**RE: Request for Regulatory Appeal by Westbrick Energy Ltd. (Westbrick)
Lightstream Resources Ltd. (Lightstream)
Application No.: 1843804 (Application)
Location: 19-045-11W5
Regulatory Appeal No. 1852713 (Regulatory Appeal)**

The Alberta Energy Regulator (AER) has considered Westbrick's request under section 38 of the *Responsible Energy Development Act (REDA)* for a regulatory appeal of the AER's decision to approve a holding for Section 19-045-11 W5M. The AER has reviewed Westbrick's submissions dated February 22 and March 18, 2016 and the submissions made by Lightstream dated February 22, 2016.

For the reasons that follow, the AER has decided that Westbrick is not eligible to request a regulatory appeal in this matter. Therefore, the request for a Regulatory Appeal is dismissed.

The applicable provision of the *REDA* in regard to regulatory appeals is section 38, which states:

38(1) An eligible person may request a regulatory appeal of an appealable decision by filing a request for regulatory appeal with the Regulator in accordance with the rules. [emphasis added]

The term "eligible person" is defined in section 36(b)(ii) of the *REDA* to include:

a person who is directly and adversely affected by a decision of the Regulator that was made under an energy resource enactment, if that decision was made without a hearing.

The term "appealable decision" is defined in section 36 of the *REDA*. Specifically relevant to this regulatory appeal request is section 36(a)(iv):

36(a)(iv) A decision of the Regulator that was made under an energy resource enactment, if that decision was made without a hearing.

Reasons for Decision

The decision to issue the holding approval is an "appealable decision" as the decision was made under the *Oil and Gas Conservation Act (OGCA)* without a hearing. In order for Westbrick to be an "eligible person" to request a regulatory appeal of the holding approval, Westbrick must demonstrate that it is a person who is directly and adversely affected by the AER's decision to issue the holding approval.

Westbrick and Lightstream are joint owners of mineral rights in Section 19: Westbrick holds 67.5% while Lightstream holds 32.5%. The parties have signed a Joint Operating Agreement for the operation of Section 19 which incorporates the 1990 CAPL Operating Procedure (Operating Procedure).

Westbrick submits that it is directly and adversely affected by the AER's approval of the holding. Westbrick is concerned with the potential operation of the penalty provisions in the Joint Operating Agreement changing the mineral rights interests of the working interest holders, thereby negating common ownership in Section 19.

Westbrick submits that the Operating Procedure operates such that when a working interest holder in Section 19 does not participate in an independent operation involving drilling of a well, the entire beneficial interest (100%) in the working interest held by the non-participant is effectively wholly transferred to those working interest holders who participated in the well. The operation of the Joint Operating Agreement, including the Operating Procedure, strips the non-participating working interest holder of most if not all its ownership rights and obligations – including all benefits and liabilities – until the penalty is paid and perhaps permanently, under certain circumstances. Westbrick submits once Lightstream Wells #1¹ and #2² were drilled and placed into operation, Lightstream obtained 100% of the beneficial interests in those wells. The result of which is that when Lightstream filed the Application, common ownership did not exist in Section 19 and the AER erred by approving the holding.

Section 4.021(2) of the *Oil and Gas Conservation Rules (OGCR)* states that, "No well shall be produced unless there is common ownership throughout the drilling spacing unit". Therefore, common ownership in the drilling spacing unit (DSU) is required in order for a well to produce.

Section 5.190 (1) and (2) of the *OGCR* provide that

- (1) The Regulator, on application and by order, may establish holdings.
- (2) An application to establish holdings must be made in accordance with Directive 065 and must include any other information that the Regulator requires.

Section 5.200 of the *OGCR* provides that,

A holding shall contain only

- (a) a single drilling spacing unit of common ownership, or
- (b) whole, contiguous drilling spacing units of common ownership.

Section 1.020(2)(4) of the *OGCR* provides the test for common ownership in a DSU and a holding as follows:

- (a) when that term is used in connection with a block, holding or project
 - (i) that the ownership of the lessors' interests through the block, holding or project is the same and the ownership of the lessees' interests through the block, holding or project is the same, or
 - (ii) that the owners of the lessor's interests and the lessee's interests throughout the block, holding or project have agreed to pool their interests,

or

¹ The 100/03-19-045-11 W5M well.

² The 104/01-19-045-11 W5M well.

- (b) when that term is used in connection with a drilling spacing unit,
 - (i) that the owners of the lessee's interest throughout the drilling spacing unit are the same, or
 - (ii) that the owners of tracts within the drilling spacing unit, as defined in section 78 of the Act, have agreed to pool their interests or the Regulator has ordered that all tracts within the drilling spacing unit be operated as a unit under Part 12 of the Act;

This is confirmed in Section 7.2.7.1 of *Directive 065: Resources Applications for Oil and Gas Reservoirs (Directive 065)* which states, "Common mineral rights ownership at both the lessor and lessee levels is a prerequisite for establishing a holding. A holding area must consist of at least one DSU or whole, contiguous DSUs of common mineral ownership."

Westbrick and Lightstream entered into a Joint Operating Agreement so the parties could drill and produce gas wells in the DSU. Westbrick submits that *Directive 065* is express that private agreements, such as a farm-in and out agreement, can result in a change of ownership so that it is no longer common throughout the area of a holding. Westbrick argues that the operation of the Joint Operating Agreement between Westbrick and Lightstream is not a pooling agreement and the agreement did in fact change the ownership of mineral rights.

Directive 065 specifically states:

As defined in Section 1.020(2)(4) of the OGCR, holdings require common ownership at both the lessor and lessee levels in the area of the holding. A farm-in or farm-out agreement has the potential to change the ownership so that it is no longer common throughout the area of a holding.

Directive 065 specifically refers to the potential for a farm-in or farm-out agreement to change ownership in the area of a holding. However, Westbrick and Lightstream do not have a farm-in or farm-out agreement. Both parties agree that private agreements can affect the ownership of mineral interests within a holding, but Lightstream submits that neither the Joint Operating Agreement, nor the Operating Procedure, do so in this case. Lightstream explains that in a typical farm-in or farm-out agreement, the "farmee" or acquiring party can earn all or some portion of the lessee interest previously owned by the "farmer" or disposing party. As such, a farm-in or farm-out involves an actual and express conveyance of ownership interests. Ownership of lessee interests (beneficial or otherwise) remains unchanged by the penalty position that a nonparticipating party opts into.

Westbrick claims that the AER erred in finding that common ownership remains in Section 19 and by doing so, Westbrick submits that it is has been adversely affected by the issuance of the holding approval. Westbrick is relying on the fact that it elected to go penalty under its Joint Operating Agreement, as the basis upon which common ownership has failed. Joint Operating Agreements are common private agreements used within the industry and the option of a Working Interest Participant to go penalty under its private agreement is a common occurrence in the oil and gas industry.

Simply electing to go penalty does not necessarily result in a party losing its mineral rights. Westbrick does not allege nor has it provided evidence that its mineral interests have been conveyed to another party. Private agreements, such as farm-ins, can result in such transfers or conveyances of mineral interests; however, there is no evidence that this has occurred in this case. Westbrick only alleges that it is not receiving the benefit of such interests due to the penalty provisions in its private agreement. Westbrick does not allege that the Joint Operating Agreement does not continue to apply to the interests of the parties or has for some other

reason failed. The AER is of the view that, for the purpose of compliance with the common ownership under Section 5.200 of the OGCR, both Westbrick and Lightstream's mineral rights in Section 19 remain the same as before the holding approval was issued; however, Westbrick's mineral interests are subject to the penalty provision under the Joint Operating Agreement. Although Westbrick may not be receiving the full benefit of its interests due to its election to go penalty, the requirement for common ownership remains met.

Further, the adverse impact that Westbrick alleges is a result of it exercising its rights under the Joint Operating Agreement to not participate in the drilling of wells and be subject to the penalty provision. These consequences are not a direct or necessary result of the AER's decision to approve the holding. Whether or not Westbrick is adversely affected by a penalty provision under the Joint Operating Agreement is a decision by Westbrick to not participate in the well, thereby incurring the penalties set out in the parties' private agreement. As the potential adverse impact would be as a result of a voluntary decision by Westbrick to not participate in additional wells, Westbrick has not demonstrated that the adverse effect is a result of the AER's decision to approve the holding.

The AER notes that the requirement for common ownership is closely connected to the purposes of the OGCA. Section 4(c) provides that one of the purposes of the Act is to afford each owner the opportunity of obtaining the owner's share of production of oil or gas from any pool. In this case, the AER is satisfied that Westbrick has the opportunity of obtaining its share of the production of gas from the pool and has decided to go penalty on its own initiative.

The AER's determination that Westbrick continues to hold mineral interests in satisfaction of the common ownership requirements under the OGCR is not a final or conclusive determination of the rights of the parties under the Joint Operating Agreement. The ultimate authority on the interpretation and enforcement of private agreements belongs to the courts. Accordingly, Westbrick is able to seek a decision from the courts that it does not, in fact, retain mineral interests in section 19 by operation of its private agreements. Upon receiving such a decision, Westbrick can file an application to rescind the holding and the AER will review and determine the impacts of the court's decision on the requirements of common ownership as it applies to the Section 19 holding.

Given the above, Westbrick is not an "eligible person" and has failed to meet one of the requirements for a regulatory appeal of the decision to issue the holding approval.

Other Grounds

Westbrick has also raised other grounds in its request for regulatory appeal that do not go to the issue of whether it is directly and adversely affected. One such ground is that the AER did not provide reasons for the approval of the holding in its letter of February 9, 2016 or in the approval document (the Spacing Disposition). Westbrick states that the approval document was devoid of reasons, did not disclose the reasons for the approval of Application No. 1843804 and merely sets out that the AER issued the applied for approval.

The AER's February 9, 2016 letter relates to the AER's considerations in exercising its discretion to not hold a hearing to consider Application No. 1843804. Westbrick cannot seek a regulatory appeal of the AER's decision not to go to a hearing as that decision was made under REDA. As per sections 36 and 38 of REDA, the only decisions that can be regulatory appealed are decisions made under the energy enactments, the specified enactments and any other decision or class of decisions described in the regulations.

With respect to Westbrick's concerns that no reasons were given in the approval document for why the AER approved the holding application, implicit in every approval is that the application met the relevant requirements for such an approval to be issued. Westbrick's argument is irrelevant to the question of whether it is an "eligible person" or whether the decision is considered an "appealable decision". This ground of appeal does not address the test for a regulatory appeal.

Westbrick also raises concerns about insufficient, questionable and conflicting evidence being filed on Application No. 1843804 and about new information it has received. The AER is of the view that these submissions go to the merits of the regulatory appeal rather than to the issue of whether Westbrick has met the test for a regulatory appeal. As above, Westbrick's argument is irrelevant to the question of whether it is an "eligible person" or whether the decision is considered an "appealable decision". This ground of appeal does not address the test for a regulatory appeal.

Conclusion

For the foregoing reasons, the AER finds that Westbrick is not directly and adversely affected by the AER's decision to issue the holding approval for Section 19-045-11-W5M. Accordingly, Westbrick has not met the requirements for a regulatory appeal and the AER has decided to dismiss the request for a regulatory appeal in accordance with Section 39(4) of *REDA*. Given this result, it is not necessary for the AER to decide Westbrick's request for a stay of the holding approval or its request for alternative relief.

Sincerely,



Tom Byrnes, P.Eng.
Senior Advisor, Industry Operations



K. Fisher
Manager, Regulatory Effectiveness



Brad Hubbard, P.Eng.
Senior Advisor, Strategy and Regulatory

cc: Derek Jahns, Westbrick Energy Ltd.
Cameron Chiasson, Lightstream Resources Ltd.