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The Mining and Lands Commissioner
Le Commissaire aux mines et aux terres

File No. OG 008-02

L.F.G. Carter)
Deputy Mining and Lands Commissioner)

Wednesday, the 23rd day of July, 2003.

THE OIL, GAS AND SALT RESOURCES ACT

IN THE MATTER OF

An application under clause 8(2) of the **Oil, Gas and Salt Resources Act,** R.S.O. 1990, c. P. 12, as amended by S.O. 1994, C. 27, S. 131 and 1996, C. 30, ss. 56-70; 1998, C. 15; Sched. E, S. 24,1999, C. 12, Sched. N, S. 5; 2000, c.26; Sched. L, s. 6(2) and Section 15 of Ontario Regulation 245/97, amended to O. Reg 22/00, for an Order, hereafter referred to as "The Application for Unitization of the Zone "B" Pool", that; (a) the oil or gas interests within a unit area containing a pool, part of a pool, oil or gas field or part of an oil or gas field be joined for the purpose of drilling or operating oil or gas wells, (b) management of the drilling or operation be carried out by the initial unit operator further described in this Order, and (c) the costs and benefits of such drilling or operation within the unit area be apportioned in the manner specified within this Order.

(Amended July 23, 2003)

BETWEEN:

LAGASCO INC.

Applicant

-and-

ALL LEASED LANDOWNERS, UNLEASED LANDOWNERS AND LEASE INTEREST HOLDERS IN THE ZONE "B" POOL more particularly described in Schedule "D" attached hereto and forming a part of this Order.

Respondents

(Amended July 23, 2003)

AND IN THE MATTER OF

The Application by Lagasco Inc. (Applicant) for an Order joining the specific interests of .Russell Leigh Bodkin, Florence Jean Bodkin, Lorraine Anne Van Damme, Roger Cecil Oliver, Donald Albert Havens and Donald Arlo Bodkin (collectively known as the "Leased Landowners") of Tracts #1, #2, #5 and #6 further described in Schedule " A " attached to and forming a part of this Order.

(Amended July 23, 2003)

AND IN THE MATTER OF

The Application by Lagasco Inc. (Applicant) for an Order joining the specific interests of Christopher Anthony Lovell, Della Marie Lovell, and Roger Cecil Oliver (collectively known as the "Unleased Landowners") of Tracts #3 and #4 further described in Schedule " B " attached to and forming a part of this Order.

(Amended July 23, 2003)

AND IN THE MATTER OF

All and singular those certain parcels, lots or tracts of land and premises, situated lying and being in the East half of Lot 11 and the East half of Lot 12, Concession 4 and the West Half of Lot 11 and the West half of Lot 12, Concession 5, in the Geographic Township of Zone, formerly the County of Kent, now in the Municipality of Chatham-Kent, Province of Ontario, identified as Tracts #1 through #6 and more particularly described in Schedule " A " attached hereto and forming part of this Order hereinafter referred to as the "Unit Boundaries".

(Amended July 23, 2003)

ORDER FOR COMPULSORY UNITIZATION

WHEREAS a Hearing was held in this matter commencing at nine-thirty o'clock in the forenoon on the 11th day of February, 2003, adjourning at six-fifty o'clock in the afternoon and recommenced at nine-thirty o'clock in the forenoon on the 12th day of February,2003, with final submissions heard in conjunction/tandem with the application dealing with the Zone "C" Pool, commencing at three o'clock in the afternoon. The hearing was held in the Wedgewood Room of the Wheels Inn, at 615 Richmond Street, Chatham, Ontario, with Mr. Christopher J. Lewis, Counsel for the Applicant, having introduced evidence and made submissions and Mr. Jed Chinneck, Counsel for a group of the Respondents having introduced evidence and made submissions opposing the Application. No one from or representing the other Respondents appeared opposing the application.

AND WHEREAS the Applicant, Lagasco Inc. has obtained Petroleum and Natural Gas Lease(s)/Grant(s) with a majority of landowners (approximately 93.75%) in the proposed unit area. And the Applicant has 100% of the designated participating acreage under Petroleum and Gas Lease(s)/Grant(s).

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AND WHEREAS to promote the conservation of oil, gas and unitized substances, to prevent waste, to allow the greatest ultimate recovery of unitized substances and to ensure to each of the parties to this Order obtaining his, her or their equitable share of unitized substances produced under and by virtue of the terms of the Unitization Order, it is deemed necessary and desirable to unitize the lands, oil and gas leases, formations and substances hereinafter described.

UPON reading the documentation filed in support of the application and upon hearing the evidence;

1. **THIS TRIBUNAL ORDERS** that the Title of Proceedings be amended accordingly by deleting all words specifically the parties found after "Applicant" and replacing them with the words, "-and- ALL LEASED LANDOWNERS, UNLEASED LANDOWNERS AND LEASE INTEREST HOLDERS IN THE ZONE "B" POOL - Respondents -", more particularly described in Schedules " B " and " D " attached hereto and forming part of this Order.

2. **THIS TRIBUNAL FURTHER ORDERS** that the interests of the unleased landowners known as Christopher Anthony Lovell and Della Marie Lovell in the form of a Petroleum and Natural Gas Lease(s)/Grant(s) to Lagasco Inc. as at January 1st, 2003 which is further described in Schedule " C " attached hereto and forming part of this Order.

3. **THIS TRIBUNAL FURTHER ORDERS** that this Order for Unitization will be effective on the 1st day of January, 2003.

4. **THIS TRIBUNAL FURTHER ORDERS** that the unit to be known as the Zone "B" Pool shall be described as all and singular those certain parcels, lots or tracts of land and premises, situated, lying and being in the Geographic Township of Zone, formerly the County of Kent, now in the Municipality of Chatham-Kent, Province of Ontario, being Tract #1, #2, #3, #4, #5 and #6 more particularly described in Schedule " A " attached hereto and forming part of this Order, being of the Silurian Age.

5. **THIS TRIBUNAL FURTHER ORDERS** that the unit boundaries, tracts and participating section of the Zone "B" Pool shall be in accordance with the Plan marked as Schedule " A " attached hereto and forming part of this Order, and **FURTHER ORDERS** that the allocation of each of the Leased Landowners oil and gas interests shall be as set out in the Summary of Tract Allocation, in accordance with Schedule " D " attached hereto and forming part of this Order.

6. **THIS TRIBUNAL FURTHER ORDERS** that the interests of the Applicant, Lagasco Inc., and the interests of the Respondents, described in Schedule " A " attached hereto and forming part of this Order, being all Landowners in the unit known as the Zone "B" Pool, more particularly described in Schedule " D ", attached hereto and forming part of this Order, be and are hereby joined and unitized, for purposes of drilling or operating wells, being for the purposes of oil and gas production.

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7. THIS TRIBUNAL FURTHER ORDERS that the relationship between the Applicant, Lagasco Inc., and the Respondents, being all Landowners in the Zone "B" Pool, be regulated in respect of such lands as if each of them had reached agreement on the terms and conditions, as set forth in the Unit Operation Agreement, being Schedule " E ", attached hereto and forming part of this Order and attaching to any pre-existing agreement in respect of oil and gas rights in the Zone "B" Pool accordingly.

8. THIS TRIBUNAL FURTHER ORDERS that where conflict occurs between the Unit Operation Agreement and this Order, the terms of the Order shall prevail.

9. THIS TRIBUNAL FURTHER ORDERS that the Unit Operating Agreement may be amended by the Applicant, Lagasco Inc., with the agreement of no fewer than that number of Leased Landowners corresponding with 60 (sixty) per cent of the unit area of the Zone "B" Pool, or , if amended as may be amended from time to time, for the purposes of expanding the size of the unit area through inclusion of additional lands, under lease, in the vicinity of and abutting the current unit area:

(a) by executing an agreement with the Leased Landowner(s) which conforms with the Unit Operation Agreement attached to this Order as Schedule " E ", with the necessary modifications;

(b) by serving on each Leased Landowner a copy of this Order of Compulsory Unitization, with Schedules attached; and

(c) by registering on title on the lands of each of the aforementioned Leased Landowners, or additional, a Unit Amending Agreement along with schedules attached setting out the following information:

- (i) a plan of the defined unit area;
- (ii) the metes and bounds of the enlarged or reduced unit area; and
- (iii) a summary showing the names of the individual Landowners and tract allocation of each party's oil and gas interest within the tract and unit area

10. THIS TRIBUNAL FURTHER ORDERS that, in accordance with subsection 15(4)(g) of O. Reg. 245/97, amended by O. Reg. 22/00, the Applicant, Lagasco Inc., is appointed as the Initial Unit Area Operator.

11. THIS TRIBUNAL FURTHER ORDERS that the royalty payments to Leased Landowners shall be as set out in Clause No. 3 of the Unit Operation Agreement, Zone "B" Pool, and shall be determined on an areal basis, in accordance with Schedule " D " attached to and forming part of this Order.[1]

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[1] The royalty payments are to be in accordance with Clause No. 3 of the Unit Operation Agreement, attached as Schedule "E".

12. THIS TRIBUNAL FURTHER ORDERS that service of the Order will be affected by the tribunal by regular mail and by the Applicant, Lagasco Inc., through regular mail delivery to the residences of the Landowners as indicated on Schedule "D" attached to and forming part of this Order.

13. THIS TRIBUNAL FURTHER ORDERS that this Order shall be effective until such time as all of the recoverable oil and gas reserves in paying quantities have been produced from the Zone "B" Pool, and without limiting the generality of the foregoing, continuing as long as the leased substances are produced from the Zone "B" Pool, as may be enlarged or reduced from time to time, or until such time as all wells located on the aforementioned pool have been abandoned or plugged.

14. THIS TRIBUNAL FURTHER ORDERS that the Unit operation Agreement shall include the clause; The parties to this agreement hereby recognize that the terms of this Unit Operation Agreement may be modified or affected by statues, or any regulation, order, or directive of any applicable government or government agency.

15. THIS TRIBUNAL FURTHER ORDERS that the Unit Operation Agreement be modified and amended to include the wording; "The parties to this agreement recognize that the terms of this Unit Operation Agreement may be modified or affected by statute, regulation, order, or directive of any applicable government or government agency."

16. THIS TRIBUNAL FURTHER ORDERS that no costs shall be payable by any party to this application.

17. THIS TRIBUNAL FURTHER ORDERS that upon payment of the required fees, Notarized Copies of the Order be filed by counsel for the applicant in the Chatham Land Registry Office, Kent #24, 40 William Street North, Chatham, Ontario N7M 4L2, on lands corresponding to each of the Tracts listed in Schedule " D ", attached hereto and forming part of the Order.

18. THIS TRIBUNAL FURTHER ORDERS that this Order is binding on the Applicant and the Leased Landowners and their executors, heirs, successors or assigns.

Reasons for this Order are attached

DATED this 23rd day of July, 2003.

Original signed by
L.F.G. Carter

Lorne F.G. Carter
Deputy Mining and Lands Commissioner

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File No. OG 008-02

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Wednesday, the 23rd day of July, 2003.

THE OIL, GAS AND SALT RESOURCES ACT

IN THE MATTER OF

An application under clause 8(2) of the **Oil, Gas and Salt Resources Act,** R.S.O. 1990, c. P. 12, as amended by S.O. 1994, C. 27, S. 131 and 1996, C. 30, ss. 56-70; 1998, C. 15; Sched. E, S. 24,1999, C. 12, Sched. N, S. 5; 2000, c.26; Sched. L, s. 6(2) and Section 15 of Ontario Regulation 245/97, amended to O. Reg. 22/00, for an Order, hereafter referred to as "The Application for Unitization of the Zone "B" Pool", that; (a) the oil or gas interests within a unit area containing a pool, part of a pool, oil or gas field or part of an oil or gas field be joined for the purpose of drilling or operating oil or gas wells, (b) management of the drilling or operation be carried out by the initial unit operator further described in this Order, and (c) the costs and benefits of such drilling or operation within the unit area be apportioned in the manner specified within this Order.

(Amended July 23, 2003)

BETWEEN:

LAGASCO INC.

Applicant

-and-

ALL LEASED LANDOWNERS, UNLEASED LANDOWNERS AND LEASE INTEREST HOLDERS IN THE ZONE "B" POOL more particularly described in Schedule " D " attached hereto and forming a part of this Order.

Respondents

(Amended July 23, 2003)

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AND IN THE MATTER OF

The Application by Lagasco Inc. (Applicant) for an Order joining the specific interests of Russell Leigh Bodkin, Florence Jean Bodkin, Lorraine Anne Van Damme, Roger Cecil Oliver, Donald Albert Havens and Donald Arlo Bodkin (collectively known as the "Leased Landowners") of Tracts #1, #2, #5 and #6 further described in Schedule " A " attached to and forming a part of this Order.

(Amended July 23, 2003)

AND IN THE MATTER OF

The Application by Lagasco Inc. (Applicant) for an Order joining the specific interests of Christopher Anthony Lovell, Della Marie Lovell, and Roger Cecil Oliver (collectively known as the "Unleased Landowners") of Tracts #3 and #4 further described in Schedule " B " attached to and forming a part of this Order.

(Amended July 23, 2003)

AND IN THE MATTER OF

All and singular those certain parcels, lots or tracts of land and premises, situated lying and being in the East half of Lot 11 and the East half of Lot 12, Concession 4 and the West Half of Lot 11 and the West half of Lot 12, Concession 5, in the Geographic Township of Zone, formerly the County of Kent, now in the Municipality of Chatham-Kent, Province of Ontario, identified as Tracts #1 through #6 and more particularly described in Schedule " A " attached hereto and forming part of this Order hereinafter referred to as the "Unit Boundaries".

(Amended July 23, 2003)

REASONS

This matter was heard on Tuesday, February 11th, 2003, commencing at nine thirty in the forenoon at the Wedgewood Room of the Wheels Inn, 615 Richmond Street, Chatham, Ontario.

Appearances by;

Christopher A. Lewis	Counsel on behalf of the Applicant, Lagasco Inc.,
Jed M. Chinneck	Counsel for a majority of the Respondents,

No one attended on behalf of the remainder of the Respondents

Preliminary/Procedural Matters

It was submitted by Mr. Chinneck that the hearing of the Zone "C" Pool application scheduled for February 12th, 2003 (next day) be brought forward and included in the hearing for the Zone "B" Pool application scheduled for February 12th, 2003 (this day). He provided evidence [Exhibit #13] and submitted that the Respondents to the Zone "C" Pool application were agreeable to moving the Hearing to February 11th, 2003 and being included with the application for the Zone "B" Pool.

Mr. Lewis submitted that the terms of the notices served have to be up-held. The notices have been sent out announcing the two dates of the hearings with specific reference that the Zone "B" Pool application is to be heard on February 11th, 2003 and the Zone "C" Pool application is to be heard on February 12th, 2003. While he understands that evidence in one may well be the same for the other they are in fact separate applications/issues.

This Tribunal finds that notice is in fact specific as to each application and includes separate hearing dates. While the hearings are only one day apart and will likely produce inter-related evidence[1] the issue of service of notice must be maintained. Those Respondents for the Zone "C" Pool application may well have the intentions of attending on the second day and applying to make submissions. The rights of the Respondents in either application may well be circumvented if the applications where jointed for a hearing. The tribunal will maintain the two applications within separate hearings.

Mr. Chinneck further submitted that he was requesting the inclusion of Mr. E. Hewitt (M.N.R.) as a witness for the Respondents to be questioned on matters pertaining to trust account conditions within the Unitization Agreement that is to be argued for inclusion in any compulsory Order of the Deputy Commissioner. He submitted that it is the Respondent's contention that a special trust for the cost of plugging of wells has to be included in the Order.

Mr. Lewis submitted that while he did not object to Mr. E. Hewitt's testimony on M.N.R. policy within his station he did object to arguments on special trust conditions for good reason. He submitted that the tribunal does not have the authority or jurisdiction to rule and consider the special trust conditions within an order.

Upon due deliberations, the Tribunal provided the explanation that it is compelled to hear the arguments both for and against the issue of ordering a special trust condition. The tribunal invited both parties to submit on the issue of a special trust and the ensuing findings within the Compulsory Order will address the issue of jurisdiction in such matters.

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[1] Postscript - In hind-sight the evidence of the Zone "B" Pool application was adopted in its entirety into the Zone "C" Pool application at the second day hearing and no new/additional Respondents surfaced for the second day of hearing for the Zone "C" Pool application.

Service

Mr. Lewis provided an affidavit of service [Ex. 11] by R. Gilders-Barrow sworn before B. L McGregor, a Commissioner, noting the service of the Application for the Unitization of the Zone "B" Pool and on the Zone "C" Pool on the Respondents listed in Schedule "B" attached to this Compulsory Order. In addition the service of the Applicants' reply (Mr. C. Lewis) to the Respondents Reply of Mr. J. Chinneck on the Respondents as follows:

(a) Mr. J. Chinneck
(b) Mr. Christopher A. Lovell and Ms. Della Marie Lovell
(c) Mr. Roger C. Oliver
(d) Bank of Montreal, London, Ontario

The Tribunal finds notice of the hearing was reasonably delivered to those directly affected by the application proceedings.

Background

The Zone "B" Pool has two wells situated within its boundaries. Both Well #22 and Well #87 were drilled in 1949 under permits issued to the Union Gas Company of Canada, which was developing the area. The wells and area leases are currently owned by Lagasco Inc. From the 1980's to 2000, the landowners and the predecessor operating companies tried to negotiate revised terms for the lease contracts, but to no avail or compromise. Each party defended their concerns with diligence. The attempts to negotiate became of greater concern in the 90's and efforts to draw on the Ministry for resolution and the demise of the head of producing operations stalemated the situation. In the time frame well production diminished. Amalgamation of production efforts under unitization is considered as the best course of operating the field into the future.

In 1999, as a result of legislative and administrative changes the permit wells changed to operate on issued Licence(s) Number 8878 (#22) and Number 8833 (#87). These licences were issued to Lakeville Holdings Inc. the operator of record at the time.

Well #22 is shut-in as a result of an MNR inspection order issued October 25th, 2000 (I.O. #6-00-RWS) which ordered it closed because of non production for the past twelve months prior to October, 2000 and is further ordered under section 7.0 of the **Oil, Gas and Salt Resources Act** to have the well producing by January 31, 2001.

Well #87 is currently suspended as a result of an MNR inspection order issued October 25th, 2000 (I.O. #9-00-RWS) which orders the operator under section 7.0 of the **Act** to provide evidence of pooling the spacing unit or cease production by November 10th, 2000.

Efforts to resolve issues; sign the last two landowners into a lease, voluntarily unitize the landowners under subsection 8(3) of the Ontario Regulations 245/97, amended by O. Reg. 22/00 and place either well back on production, have been ongoing and unsuccessful since October 2000. An application was made on December 17th, 2002 to the Office of the Mining and Lands Commissioner for a Compulsory Order for Unitization.

Salient to the application process for "joining", is the seeming silence of some older lease terms on the subject of pooling and/or unitization and the need to include parties not currently under a Petroleum and Natural Gas Lease/Grant. Subordinate to the application is the subject of some mortgage interest parties.

Issues

1. Can the purpose of the **Oil, Gas and Salt Resources Act** be ascertained?

2. If granted, is the purpose of Unitization of a pool/field clear and understandable?

3. Should the application be granted, what is the effect of the Unit Operation Agreement proposed in relation to the terms set out in the various leases of the Leased Landowners?

4. If granted, what should the effective date and term of the ordered compulsory unitization be?

5. Is the tribunal in a position to award and assess costs related to the hearing process?

EVIDENCE

This summary is provided from direct examination, cross examination (six witnesses) and submissions by Counsel.

Mr. Peter Miller, the company field manager, provided evidence on the well operations noting that both wells (#22 and #87) have not been operational since the company take-over in 1992. He referred to the Ministry Inspection Orders for the record (Inspection Order #6-00-RWS, October 25th, 2000 - Licence # 8878);

> Contravention: The well known as Union No. 22, Zone 8-12-V has not been on production within the last 12 months.
> Order: Lakeville Holdings Inc. is hereby ordered under section 7 of the Oil, Gas and Salt Resources Act to have the above mentioned well on production by January 31st, 2001.
>
> You are reminded that under section 7.02(1) of the Oil, Gas and Salt Resources Act, you have the right to appeal this order to the Minister...

and (Inspection Order #9-00-RWS. October 25th, 2000 - Licence # 8883)

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> Contravention: A review of our records show the well known as union No. 87 Zone 8-11-V to be an active natural gas well. This well is producing from an unpooled spacing unit contrary to section 13 (4), (5) of Regulation 245/97 made under the Oil, Gas and salt Resources Act. The spacing unit for Union No. 87 is comprised of tracts 7 and 8 of Lot 11, Concession V and tracts 1 and 2 of Lot 11, Concession IV all in Zone Township, Kent County as stipulated on the well licence #8883.
> Order: Lakeville Holdings Inc. is hereby ordered under section 7 of the Oil, Gas and Salt Resources Act to provide proof of pooling the spacing unit for the well known as Union No. 87 or cease production from the well by November 10, 2000.
>
> You are reminded that under Section 7.02(1) of the Oil, Gas and Salt Resources Act, you have the right to appeal this order to the Minister within 30 days after it is issued.

This application is expected to rectify the situation. Other than the Inspection Orders, there were no other outstanding issues with the Ministry concerning the operations.

There are approximately thirty wells producing 140 MCF per day in the three Zone fields. Overall Lagasco has ninety-four wells under licence in the Province. In reference to the Record of Technical Data [Ex. 1, Tab 8]. Mr. Miller reviewed the content and noted that the Ministry concurred with the Zone "B" Pool as proposed.

The previous operator, Mr. Gout's company, had attempted to modernize the leases and have the landowners enter into a unitization agreement which proved unsuccessful. Mr. Gout was the primary negotiator in these matters which hampered negotiations due to his inflexibility and heavy-handed tactics with the landowners.

Over the approximate 10 miles of pipeline in the gathering system, Lagasco experienced fifteen to twenty leaks last year. The system is aging and rusted areas are noticeable. As a result the system has experienced blow-outs from some leaks causing some crop damage. It is the nature of the business and the frequency is not significant in Mr. Miller's estimation. Mr. Miller added that it is the company philosophy to keep good relations with the area farmers and when crop damage occur the repairs are made and the farmer is duly compensated for the loss. A twenty-four hour a day eight hundred telephone number is posted for reporting problems observed and this is a licencing requirement. The Provincial operating standards are being met and regular daily checks are scheduled for the system.

The system production volumes are recorded by meters and based on the latest Walsh report a reasonable production picture can be expected for the field. The meters are calibrated yearly (industry standard practice) and it is estimated that 140 MCF is required to maintain the system.

The company considers the liability for plugging each well is from $10,000 to $15,000 each and may be as high as $16,500. Basically the landowners have asked for an abandonment cost clause and a better royalty percentage return. The previous operating company had offered to create a separate trust fund. Mr. Miller noted that this was rejected by the landowners given their mistrust of the administration of the trust fund.

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Ms. Kathy McConnell, a geologist and consultant in the oil and gas industry, explained that the Zone "B" Pool unit operation agreement [Ex. 1a, Tab 16] is comprised of six land tracts. She indicated which of the lands will be participating acreage and non-participating acreage. The lands owned by Mr. and Mrs. Lovell and Mr. R. Oliver (unleased landowners) are totally in the non-participating group. Six landowners have participating acreage of approximately 150 acres, and one hundred percent of the participating area is currently under lease to Lagasco Inc. Ms. McConnell concluded that well No. 87 is situated on Mr. Donald Haven's property (Tract #5) and well No. 22 is situated on Mr. Donald Bodkin's property (Tract #6).

She highlighted the terms of the purposed Petroleum and Natural Gas Lease/Grant(s) [Ex. 1.a, Tab 15] and the Unit Operation Agreement [Ex.1.a, Tab 16] and drew attention to the term differences in the drafted documents from those terms suggested by the Respondents. There is agreement on the 12.5 percent royalty, but differences on the points of volume calculations and the $10 per acre rental fee. The Respondents have suggested restrictions on land and carbonate zone access which she considered to be contrary to; the existing lease arrangements, the **Regulations,** Standards and the **Act.**

Ms. McConnell concluded naming Lagasco Inc. as the Initial Unit Operator and requested the effective date of the ordered agreements to be January 1st, 2003.

Mr. P. Walsh, expert witness and consultant to the Applicant, outlined his credentials as a Geologist, MBA with current studies toward a Ph.D. (geology) and his extensive field experience. He indicated previous involvement with predecessor companies (Lakeville Holdings and Lagasco Corp.). He consulted for Lagasco Inc. through his consulting firm, Energy Objectives Ltd., however, he has no ownership interest in Lagasco Inc. Two studies have been conducted on the Zone fields. The 2000 report provided a basis for landowner negotiations and the 2002 report was designed to deal with this application for compulsory unitization

Mr. Walsh reflected on the definition of an expert and noting that an individual who has education in the field and considerable direct working knowledge may have sufficient expertise to make hearing presentations. However, a passing desire or passion for knowledge on the subject matter of this industry is not enough to be considered an expert.

He indicated support for unitization of the Zone fields. Pooling, he explained, is recommended in situations with only one well and unitization is recommended in situations with a multiple of well locations. Support for unitization of this pool is found in the Office of the Mining and Lands Commissioner publication[2] at page 7.;

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[2] Office of the Mining and Lands Commissioner - publication, Queen's Printer, entitled " Oil, Gas, and Salt Resources Act, Document of Explanation", 2000.

> The benefits of unitization to the operator includes streamlined operations, centralized facilities and a lower economic production limit due to lower operating costs and additional recovery of oil and gas. The benefits of unitization to landowners include a longer production life of the pool (more royalties), less surface production equipment and a guarantee of a share in production regardless of whether a well is located on their land or spacing unit. The latter benefit occurs since all production from a unitized pool is deemed to have come from all interest owners.

There is a reasonable expectation that this location will produce gas/oil from under certain lands. Production statistics will provide the information on whether to make the decision to extend or contract the participating area and the unit operation agreement will provide for the flexibility to do so.

He recommended the metering of each well in Zone "B". The essence of unitization, according to his reference Ballem[3], is to reduce waste and provide for efficient recoveries from which the landowners will receive benefits as a result of rendering oil/gas from under their lands. The participating lands are in a silurian formation found under several different tracts which will share in the royalties from the production. The remaining lands are designated non-participating and will not share in the royalties unless a shift in the formation is recorded. The unit boundaries are the extreme outer limits of the estimated field. If it can be determined that gas exists under someone's lands, then they are entitled to royalties from the production.

Mr. Walsh stated that when the field was first drilled, sixty years ago, there was no unitization or organization of the lands and coupled with a lack of metering data it is difficult to determine the current reserves and the wandering directions of the field. Typically unitization of a producing field takes place within the initial period of a pool's productive life. Upon resumption of production from the field the independent metering will allow for a determination of the remaining gas reserves. The operator today must monitor the meter data closely in order to determine the most efficient well locations and the field layout. Based on current technical information it makes sense to unitize the operations. In the alternative, when expansion of the field is required the process may be prolonged as the operator will have to step backward to unitize the field before proceeding with production.

Current technical data indicates that Zone #22 well is at 9 MCF (9,000 cu.ft. per day of pressure) and shut-in pressure is gauged at 420 pounds per square inch versus the original pressures of 600/700 when first drilled. In the case of Zone Well #87 an MCF of 19 (19,000 cu.ft. of pressure) was recorded at 392 pounds per square inch shut-in. In terms of revenue the 28 MCF per day will produce revenues of $9 per 1000 cubic feet or a $250/$300 per day gross revenue from this Silurian gas field.

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[3] Ballem, John Bishop, The Oil And Gas Lease In Canada, 2nd Ed. (Toronto: University of Toronto Press, 1985) - From an operational point of view it makes good engineering and economic sense to operate a field as an entity without regard to any artificial distinction created by the ownership subdivisions. Unitization achieves better operating procedures, enhances recovery and implements good conservation practices at a reduced cost. Unitization is encouraged by public conservation bodies."

Mr. Walsh stated that the information filed in the old logs is being relied upon. In theory this information plus downhole geophysical logs will help determine the porosity and permeability of the reservoir. The area of the field is being estimated/determined from the drilling patterns of old wells and their historical production records collated for the Ministry of Natural Resources. The field layout/area for drilling is based on the current requirements of the Ministry where Zone Well #22 will require added tract area in Lot 12, Concession 5 and Lot 11, Concession 5. and with regard to Zone Well #87 added tract area in Lot 11, Concession 5 and Lot 11, Concession 4 is required. He pointed out other plugged or dry unproductive well locations in the area, from the referenced maps, and concluded that the area was "old and tired".

Mr. Walsh provided a review of the 2000 and 2002 reports filed. The first report (2000) was an economic evaluation pertaining to a specific point in time. The terms of reference for that report did not call for a new assessment of the geology as Lagasco Inc. was relying on Mr. Welychka's assessment at the time. The 2002 report takes in the increased demand and prices, raising the potential worth of the field. He reflected that longevity fits this situation. While production may be low, the dollar value of gas is high. The field is approximately one-half used and expectations for the field is possibly ten years, based on a flat decline rate and commodity volatility. These are old wells and generally on par with most Ontario fields. Union Gas is the marketer of the production from these fields in the Province and the volume figures they provide to the operator are sometimes two or three weeks late placing the operator at a disadvantage when producing financial information. In order to assess the viability of the reserves in Zone "B" both the physiology and economics of the pool has to be considered. The time to evaluate a field with many wells is often only after take over.

Mr. Walsh reviewed the production summaries 1989 to 2000[4], indicating that in 1996 Zone volumes were 3781.61 (10-3-M3), rising to 5830.0 in 1997, leveling back to 5402.8 in 1998, dropping in 1999 to 4793.3 and falling off in 2000 at 2719.7 and then 2329.1 in 2001. Noting the significant drop may have been the result of an increase in Ministry shut-in orders during the period, as well as, market demand drops. The market is dominated and at the discretion of Union Gas, and their acceptance of natural gas based on the market demand swings. Union Gas charges a marketing fee of 24 cents per cubic foot. Reflecting on royalties and net costs, he noted that, a 12.5 percent royalty net of compressor fuel costs will provide a return of approximately 11 percent royalty to the landowner. The trend in the industry toward market flexibility which, if adopted, will result in a greater share for those receiving royalties.

The operating company has a different ownership and management style than that of the previous operator. It is his understanding that the current operator has the duty to plug the wells. He also understands that as long as there is a chain of predecessor companies in existence, liability to do so, can/will transfer. Further, if any operator(s) is unable or non-existent the onus falls on the

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[4] 1989 to 2000 Drilling and Production Summary, Oil and Natural Gas Exploration, Underground Storage and Solution Mining in Ontario, Oil, Gas & Salt Resources Library (prepared by B. D. Parkes)

Trust/Bond fund held by the MNR and then possibly the landowner. Mr. Walsh referred to the definition of an operator[5] in the **Act** and noted that the term, to his understanding, deals with those who become both landowner and operator. Clause 10.(1)(4) of the **Act** sets out "Plugging by previous licensee[6]" as the directive for a well plugging order.

Referring to calculations in his report the $45/$50,000 forecast figure is realistic for plugging the three wells in Zone "B" and "C". The production in the older 2000 report has a negative $162,000, net of allocation, value. The capital costs of $1.05 million plus the average abandonment cost figures will bring the total liability to $1.72 million. Based on that cost figure, the current return expectations of the pool will have no value. There is a risk in operating this pool/well as there is for any other pool/well. He concluded that the trust fund deposit requirements are being met as regulated by the Ministry. There is $40,750 currently in the trust for the Lowrie operated wells and they have been allowed 10 years by the MNR authority to raise that trust monies amount to $70,000. The Lagasco company bank debt is secured and the bank is comfortable with their current arrangements and security offered. Mr. Walsh concluded that the company's philosophy is to plug wells as needed and not wait for an MNR order to do so. The Lowrie companies book assets are not sufficient to cover plugging, however Lowrie is not the only operator in the Province who has an insufficient bond amount based on the number of their wells in operation.

Mr. Walsh noted familiarity with the gathering systems based on his historical involvements and reflected that the reliability of the records is questionable. However, Well #22 was in production in 1992 and is being put forward as an operating well within this application.

Mr. Walsh provided his understanding that the information on gas production is less than adequate. The data required by the Ministry and much of what the producers have provided, and currently provide, does not meet the standards set by the Ministry. The largest producers in the Province do not provide adequate information for the public record. A producer has to manage and understand what the wells are producing based on reliable data and this unitization application addresses those concerns. If the well is not deemed to be productive then plugging and abandonment is the operator's recourse. In this case the test information indicates a commercially productive rate of gas is measurable and under sufficient pressure to produce for approximately a ten year term.

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[5] Oil, Gas and Salt Resources Act, Chapter P.12 (November 26, 2002)*,

1.(1) "operator" means, in respect of a work,

(a) a person who has the right as lessee, sub-lessee, assignee, owner or holder of a licence or permit to operate the work,

(b) a person who has the control or management of the operation of the work, or

(c) if there is no person described in clause (a) or (b), the owner of the land on which the work is situated; ("exploitant")

[6] O.G.& S.R. Act*

10.1- Plugging by previous licensee (4) If, at any time after a licence relating to a well is transferred, an order to plug the well is made under section 7.0.1 but not complied with, an inspector may require a previous licensee to plug the well at the previous licensee's expense. 1996, c.30, s.64.

Metering of each well is recommended, but once unitization takes place and there are two operating wells in the unit, it is irrelevant whether there are one or two meters as the total area production will allocated and royalties paid based on the aggregate amount for the entire unit.

The gas deposits horizons (A-1 and A-2) in Zone "B" are considered to be thin and patchy. The area is a dolomite formation where the fluids reacting with magnesium have created fractures or crevices in the limestone, trapping the gas. As evidenced by the amount of drilling in the area some wells have produced nothing worthwhile to put on production. There is an uncertainty as to where to drill, without further evidence as to where to explore. Where technical data is included; well bore analysis, geological mapping (seismic), reservoir studies (pressure data), production statistics, and economic studies the participating and non-participating boundaries are easier to determine.

The 2000 report was based on the geology information provided by Mr. E. Welynchka, a geologist hired by Lagasco Inc. Mr. Walsh stated that the same historical well information he is now relying on, for his 2002 interpretations, was available to Mr. Welynchka in the year 2000. The opinions expressed in this report on the specific areas A, B and C generally agrees with the areas outlined by Mr. Welynchka, but are defined based on the latest geological interpretation. The obvious difference in the reports is the higher economic value from today's higher prices.

Mr. Walsh paraphrased a 1969 article[7] which summarized the issues of boundary selection processes surrounding unitization. The article recognized that it is not a perfect world when dealing with oil and gas operations and determining the extent of a reservoir. The determination is made ideally from the data mentioned above, but in the real world the industry recognizes that data is sometimes in short supply so they have to use the best available information. In this case, he reported[8], the information is based on past drilling attempts and successes. The recommendations follow the Ministry designated tract boundaries that have been laid down.

The 2002 report identifies the differences between pooling and unitization. A pooling agreement does not allow for expansion of the pool into non participating areas and a unit operating agreement is flexible on such an expansion. A pooling agreement is specific as to where the well is to be placed. A unit agreement will allow for more than one well in the unit, as in this case. The Ministry, to his understanding, is comfortable with an overlap of the pooling for the two wells with production from both wells in the same horizon. An overlapping can cause complicates

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[7] Riley, E.A. "How to Speed Selection of Participation Formulas" World Oil, May 1969 - "In circumstances where an old depleted reservoir with common well density is being unitized and little or no information is available then the suggested formula for unitization would involve the number of wells producing and the acreage developed"

[8] Energy Objectives Ltd., Zone "B" and "C" Pools, Unitization Study (prepared for Lagasco Inc., December 2002, page 5. "In determining a reasonable approach to unitizing the Zone "B" and "C" Pools, an approach is being recommended that combines the unitization formula suggested...and the current policy of the Ministry of Natural Resources respecting pooling requirements for off target locations."

with the royalty and working interest positions under pooling. The technical data derived from production will determine future compensation patterns. Mr. Walsh concluded that an expansion of participating lands within a unit requires the consent of the majority of landowners affected.

Ms. Jane Lowrie, Secretary/Treasurer for Lagasco Inc., indicated that the shares of Lagasco Corp. (a publicly traded company) along with the subsidiaries Lakeville Holdings Inc. and Lagasco Inc. were acquired from the estate of Mr. Gout. Subsequently all assets were transferred to Lagasco Inc. The shares of shell company, Lagasco Corp., were sold in order to put together a profitable operating group. The current operator and Applicant is Lagasco Inc. The financing of the take-over of the faltering companies was by way of a combination of guarantees, cash injection, and renegotiating a five year term on the bank debts. The time frame of the negotiations and completion took from early 1999 until September 2000 to complete. The wells were not producing at the time of the corporate take-over. The company originally owed $2.9 million, and is now reduced to $1.8 million. In the last two years, the landowners have been paid approximately $8,000 in royalties. Today's company is solvent and meeting all obligations.

Ms. Lowrie noted that the drilling companies have to provide a well security/bond of $70,000 and based on negotiated terms the company has deposited $42,750. The Ministry's letter describing the incremental payments [Ex. 5] provides confirmation. The trust fund is an insurance policy for the plugging/clean-up of a well in the event that an operator does not comply with regulations. No defaults on any bonds or trust funds have been posted by the company under her control.

Lagasco Inc., according to Ms. Lowrie, is approximately one-fifth of the total (94) wells her companies operate. This particular company take-over had problems to work out with the trade payables, the bank and the Ministry. The result is a more efficient and profitable operation, under new controllers, with assets greater than the liabilities.

Ms. Lowrie reported that the company has plugged thirteen wells for costs in a range from $10,000 to $15,000 each and a figure of $17,000 is used in forecasting each expected plugging situation. The current wells are under plugging orders issued by the Ministry of Natural Resources on the previous owner/operators. It is her intention to produce from these wells. Once a property with a good number of wells drilled on it, is purchased, it takes time to evaluate which wells should be in production and which ones should be plugged. There are no current plans to drill fresh wells in Zone "B" in 2003. If all 94 wells needed plugging the costs would exceed the $70,000 trust fund amount. However, this scenario is unlikely because a good number of wells are producing and are ongoing operations. Well assets are constantly being sold within the industry and that there is not one operator in the Province capable of handling the plugging costs of all of their wells at once.

The wells are economically viable based on today's market price for natural gas. Production is tracked daily and if there is a noticeable drop in production, the operative staff are able to determine why. There is a flow meter planned for each well in the Zone "B" field and the compression and dehyde of the gas use will be calculated before the 12.5 percent royalty payments. Reports from Union Gas are received monthly and forwarded with the royalty cheques. These reports show the volume produced from each pool and/or the meter readings

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The 1999 financial statements for Lakeville Holdings Inc. at the time of the purchase showed a poor financial position with a negative net book value. However, the book value is not the only relevant issue in making a purchase decision. The decision to purchase was based on engineering reports from other Ontario pools and personal experience with other fields. Indications for the Zone fields are that they are depleted but can be run efficiently and produce a profit. Based on her knowledge of the statements, gas depletion figures may be recorded within the amortization figure or recorded separately as in the case of another company (Tribute Resources). In that case the figures were recorded on the statements as a "write down of petroleum and natural gas assets". Ms. Lowrie concluded that it has been their experience, upon acquiring similar fields in Ontario, that some wells are viable producers while some are dry and have to be plugged.

Mr. Andrew Hewitt, manager of the Petroleum Resources Centre, Ministry of Natural Resources in Ontario, clarified the Ministry's position noting they are not intervening in these proceedings but accepted the invitation to answer questions concerning the Standards and **Regulations**. The testimony given related to clarifications of the **Act**, trust funds, regulatory items, licencing, and the issue of well plugging liability. Mr. Hewitt described his credentials, as an engineer (American University in Cairo, Egypt) and a designate of the Minister. He stated that he is not a lawyer nor professing to give any legal opinions.

The **Act** and the **Regulation** underwent significant changes in 1997. These changes included a trust fund requirement under **O. Reg. 245/97, amended by O. Reg. 22/00** {section 16.(1)(b)} for wells drilled. The trust definition underwent several changes in the ensuing period and the current requirement is that each operator in the Province place on trust a deposit $70,000 under M.N.R. administration. Mr. Hewitt noted that the trust currently held for Lagasco is $42,750 and will be topped up to $70,000 by 2007 based on the current agreement.

Each well drilled requires licencing by the Ministry. In 1997 the **Act** changes requires every well to have a life time licence and all permit wells from 1959 onward became a licenced well. Permit wells prior to 1959 such as Well(s) #22 and #87 in Zone "B" had to be issued a licence. Mr. Hewitt referred to the licence copies appearing in the application and pointed out that the document contained the continuing operating licence numbers originally issued to Union Gas. It was further explained that an operator, prior to 1959, was required to have Ontario-wide credentials and file reports as each well was drilled. In this case, Lagasco Inc. is the Licence holder in control of the wells. Based on the new licence issue minimum conditions are placed on the Licence despite the fact that the well already exists. If an affirmative Compulsory Order is issued, the plugging order will be rescinded. Based on his subject knowledge there are no trust agreements specific to plugging wells other than the ones that are subject to the Minister's consent or release from it as a result of the 1997 **Act** and section 16 of the **Regulations.**

Mr. Hewitt responded to questions, surrounding the responsibility of landowners for abandoned well costs and noted, that the Ministry does not actively seek out wells that are not producing or suspended over one year. In theory, the Ministry goes after the wells that pose an immediate risk to the public or the environment placing a plugging order on whomever fits the definition of "operator" at the time. The plugging liability, according to Mr. Hewitt, starts with the Licence holder of record and in the event that the operating company does not exist, then the persons

in control of the well or the previous owner (Union Gas in this case) receives the inspection order. The landowner is the last resort, in the chain of liability for well plugging costs. If no previous owners can be found and legally attached to the liability the Ministry will resort to the trust fund to pay the costs of plugging. Hypothetically in this case the order would be placed on Lagasco Inc. in the first instance, then Lakeville Holdings, then the previous owners Union Gas before resorting to the Lagasco trust fund. If the trust fund is depleted and insufficient to pay the costs as a last resort, the landowners may be ordered to plug the well.

The 1997 **Act** included the landowner within the definition of 'the operator". Mr. Hewitt stated that the Ministry has not had to resort to the trust fund for any Lagasco Inc. well(s). Overall since 1997, the Ministry has not had to resort to using the trust funds of any operator in Ontario. The trust funds are for each individual operator, not a pooled trust, and it includes a clause restricting the trustee to spending from the trust only with the consent of the Minister. If one well is being cleaned-up by a third party as a result of an order and the fund is charged with the costs, the operator is required to top up the fund to $70,000 in order to continue to operate other licenced wells in their control or be ordered shut-down until the fund is restored.

Mr. Hewitt, prompted by a series of questions on the Mosa Township - Glencoe Field, from Mr. Lewis, noted that the Municipality in that case had inherited the lands through default on unpaid Municipal property taxes. Over 130 unplugged wells were discovered on the 150 acre land parcel. The land was then passed to the Public Trustee and put up for sale with the condition that the wells be plugged, a process which is no longer applicable after the 1997 **Act**. The trust is the MNR's ongoing security today. Mr. Hewitt expressed that to his knowledge, in the case of the Glencoe Fields, the commitment cost of plugging a well became the standard price of the land parcels. He stated that he was not an expert in market value analysis, but the abandoned wells obligation appeared to have an affect on the land values in this situation. In this reported case the owner(s) of lands that defaulted on Municipal property taxes was also the operator of the field.

Mr. Hewitt explained that each well in the Province requires a meter to record gas volumes (**O. Reg. 245/97, amended by O.Reg. 22/00,** section 6.). Co-mingling of more than one well on a meter is allowed only if the well is below a certain production threshold and unitization exists. Otherwise, separate metering is the norm. It was Mr. Hewitt's contention that the deviation clause under section 2. of the **Regulations** is to provide for deviation applications different from the operating Standards and not for the purpose of determining co-mingling.

If a company's assets were sold to another operator the well licences can be transferred only with the consent of the Ministry. The transfer process is by way of application and any outstanding orders would be weighted in a decision to allow a transfer. Upon the transfer of licences to a new operator, the plugging liability/obligations for those wells will become the liability of the new operator (purchaser). Any trust build-up by the previous owner is non-transferable and the new operator is obligated to post sufficient security. The Lagasco situation is a corporate purchase and a transfer of licences to a new owner.

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Mr. Hewitt was not aware of any circumstances where, upon ordering a unitization, a separate trust was mandated/included in an order. To his knowledge, in compulsory unitization application hearings held to date, there have been no additional trust obligations imposed on the Applicant within the Order, Unit Operation Agreement or the Petroleum and Natural Gas Lease/Grant. Mr. Hewitt concluded that the Ministry can order additional security funds be deposited however, the trust fund deposit figure of $70,000 may only be changed by the legislation review process.

Mr. Harry Lawson introduced himself as a landowner (49 years) in Zone and outlined his involvement with the Zone Landowners Association (chairman), the Ontario and Kent Federation of Agriculture (director), Dawn-Euphemia Petroleum Advisory Committee (since 1999), Lambton County Storage Association Steering Committee, and the Kent County Wheat Producers (since 1996). These groups focused their efforts on oil and gas industry concerns such as; orphan wells, strengthening the safeguards for landowners, fair and modern terms, gas storage, and guidance from a landowner's perspective. He apologized for not being a geologist but noted his resume' records extensive research on oil patch issues, terminology and industry history. Mr. Lawson noted his experience with contracts based solely on a handshake, some lasting over twenty-five years. Failing a fair deal, to the satisfaction of the landowners, the alternative is to get the wells plugged, sites cleaned-up, leases surrendered and the property titles cleared. It is his understanding that the landowner owns the mineral rights under the property including the gas and the landowner leases the rights to the operator accepting a fair royalty payment for the oil and/or gas extracted.

Mr. Lawson stated that the landowners are willing to agree to the pooling of the wells under a fair agreement with some guarantees that the wells are going to be plugged when required. He expressed concerns with the lack of enforcement of plugging rules and noted further that plugging decisions have to comply with the Regulations. Mr. Lawson indicated that he has no direct experience running an oil and gas operation but keeping the operation free of leaks is obviously efficient management. Responding to questions on his knowledge of Union Wells #22 and #87, he noted that production has stopped in recent years. However, previous to that he had observed leaks, crop damage and pipe breakage. It is his understanding that the Ministry have rules dealing with the pipeline maintenance and repair. Lagasco, in his estimation, is not in compliance. Mr. Lawson referred to a M.N.R. news release [Ex. 20] wherein a new homebuilder was ordered to plug a gas well because of the possible dangers it posed based on;

> "A. These restrictions are equally critical when dealing with the construction of new buildings near existing old abandoned gas wells as any disturbances may cause natural gas leaks and pool in the basement, which could cause an explosion if ignited."

Mr. Lawson noted that based on a conversation with Ministry staff it was revealed that in similar operations, old pipelines were ordered replaced and the production doubled. The operator should detect leaks with a gas sniffer and fix the leaks to enhance production and pay higher royalties. He is now aware, based on hearing evidence, that a call to the posted telephone number at pipeline sights transfers the caller to a Lagasco employee pager for their response.

Mr. Lawson noted that Mr. Walsh reported and rationalizes that unitization will provide for less waste, but it is his personal understanding that unitization of a field works best when drilling in a new pool/field. The well locations can be selected, eliminating the spacing units, and taking advantage of the most opportune locations. The existing wells are immovable so there is not a lot of saving or efficiency to be gained from this unitization. It is not appropriate here given the age of this nearly dry pool. A pooled spacing unit is more appropriate. It complies with Ministry requirements for a spacing unit and the landowners are in favour of pooled spacing units rather than unitization as a method of joining the landowners together and producing gas. Mr. Walsh is a professional geologist and qualified to draw conclusions and express his opinion. However, Mr. Lawson stated that he does not necessarily agree or accept those interpretations/conclusions.

The metering of each well separately, as recommended by the consultant, will provide more realistic production information. Royalty calculations should be made at the well head meters and the operator should have to bear the cost of the leaking gas from the pipeline system after that point. The landowners do not agree with meter co-mingling of Well No. 22 and 87 because records show the wells have different production rates. Also well status report were not filed in some instances and shut-in pressure was exactly the same for two years running indicating the previous year's figures may have been used for reporting. He has reservations with the corporate well information, in Lagasco's control, based on the records noting no use of gas for the compressor.

Mr. Lawson referred to exhibits [Exh.2 tab 3, page 2] and noted that the right bottom quadrant of Tract 2, in his estimation, is over and above what is required for the pooling. It takes in another 100 acres of land which is excessive. The 2000 Report was prepared with low figures geared to convince the landowners to take an unacceptable rent of three dollars per acre. The authors of the 2000 Report have pulled assumptions out of the air from sources which are unrealistic given that the gas values move up and down daily.

He noted that Ms. Lowrie is widely known throughout southwestern Ontario for oil and gas operations. He expressed concerns about the financial position of Lakeville Holdings and Lagasco Inc. and the information provided by Ms. Lowrie at this hearing. The company debts have been reduced by one million dollars over the past two years in contrast to royalty payments to the landowners of approximately $10/$12,000 per year. The 2000 Walsh report, according to Mr. Lawson, was prepared to show the landowners the company was short of money and could not afford additional royalties. Lagasco Inc. is a private company with information private and he is not aware of any information that will contradict the statements that the company is solvent and the debt is being paid down as agreed.

The landowners want a special plugging trust within the order that is credit proof and not controlled by Lagasco Inc. Mr. Lawson noted that under the previous owners a new lease was proposed with a special trust and terms for indefinite "commercial" operations. However the administration of that trust was questionable and only a few of the landowners accepted the new lease with a signing bonus.

The 12.5 percent royalty without deductions for transportation and compression costs is appropriate in this case given the age of the field, leases and the other factors. However, based on research, the royalty percentage offered is lagging behind other areas in North America. Mr. Lawson referred to Ballem's book (3rd edition) "Oil and Gas Lease in Canada" and noted a royalty of 18.0 percent is a common royalty payment today and in North America the most common royalty is 3/16 (18.75 percent). Other sources in Alberta record a 40 percent royalty being paid. He agreed that the landowners will be getting reasonable royalty and shut-in payments which is better than the old arrangements of $100 per year rent.

Mr. Lawson expressed concern that the wells will be operated based just on the legislation guarantee that a $70,000 trust fund can provide for an unlimited number of wells. Several sources that have been researched, concerning applications before the Ontario Energy Board[9], indicate plugging costs can be as high as $73,300 or $87,800. The ten dollars per acre per year presently offered is agreeable to the landowners but, another lease offered [Ex. 19, Bluewater, page 9-7, sec. 9] fifteen dollars per acre annually. The trust monies are not enough. Every drilled well should have sufficient money put aside by the operator to plug it.

Mr. Lawson pointed out that the various tracts should be under their proposed lease [Ex. 2, Tab 1]. In regard to Well #5 (Licence: Union #22, Zone 8-12-V, 8878) it should include only the area of the East half of Lot 11 and East half of Lot 12, Concession 4 comprising of the land parcel (75 acres) of Donald A. Havens, and the land parcel (100 acres) of Donald A. Bodkin. With regard to Well #87 (Licence: Union #87, Zone 8-11-V 8883) it should include only the area of the East half of Lot 11 and East half of Lot 12, Concession 4 and West half of Lot 11 and West half of Lot 12, Concession 5 comprising of the land parcel (75 acres) of Donald A. Havens and the land parcel (100 acres) of Florence J. Bodkin. The draft lease proposed by the landowners is relatively standard with an automatic pooling clause in it to govern the relationship between the operator and the landowners.

Mr. Lawson noted that the lease proposed by the landowner (Ex. 2, Tab 1) contains; a twenty dollar per acre bonus fee for signing, ten dollars per acre rental fee and suspended well payments of ten dollars per acre. The changes to paragraph 8 in their proposed lease deletes the word "practicable" and replaces it with the word "profitable" which better reflects the Ministry regulations. In paragraph 17, the clause "save as to this lease there is no valid lease of the leased substances..." is deleted, which places the onus on the leasing agent to ascertain the status of the landowner's property. At paragraph 22 the landowner's suggest a clause re-write, making all payments to the landowners by cheque. This will avoid the possibility of a deposit error with alike names amongst the landowners.

Mr. Lawson referred to the drafted Schedule "A" [Ex. 2, Tab 1] attached to the landowner's proposed Petroleum and Natural Gas Lease and Grant. In summary, he noted the following core changes that should be made to the lease arrangements between the landowners and the operator:

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[9] Ontario Energy Board, Union Gas Limited Century Pools Storage Development, Phase II application - RP No. 1999 - 0047, September 27th, 1999.

- Paragraph 1.; 2 pooled and Overlapping Spacing Units - Zone #22 Well and Zone #87 wherein he noted the words; "...will be and are hereby pooled in accordance with..." in two descriptive passages which, in his opinion, activates the pooling clause in the lease.
- Paragraph 2.; "Gross Royalty" wherein he records the royalty split amongst landowners at 12.5 percent of the current market value at the point of sale with no deductions.
- Paragraph 3.; "Metering" notes metering is required on each well separately.
- Paragraph 4.; "Access to Records" notes it is a requirement/right to see copies of the production figures.
- Paragraph 5.; "Plugging" wherein is the wording; "Lessee acknowledges that Provincial regulations require a well that has not produced for a year to be plugged...the Lessee undertakes to plug any well on the Said Lands, remove...pipelines and remediate [sp] the lands...as near as possible...to the satisfaction...of the...("MNR")" which, in his opinion, is set out in the Regulations.
- Paragraph 6.; "Limitation on Leased Substances" which limits the "Leased substances" to exclude anything below the A1 and A2 horizons.
- Paragraph 7.; "Limitation on Surface Rights and Drilling Rights" wherein he explained the rationale of the paragraph is for the protection of the landowners against newer wells being drilled.

The landowners are trying to be the willing participants in this gas field and, in the case of landowners Kelly and Oliver, they do not want operations to interfere with their recreational property. The landowners expectations for Zone are low and new wells drilled can be dry like previous attempts.

- Paragraph 8.; "No Storage Rights" wherein concerns are expressed about storage.

The landowners are agreeable to only production but, not storage. In support Mr. Lawson provided evidence that storage possibilities have been eliminated by an Ontario Energy Board ruling [Ex. 2, Tab 22];

> With respect to the matter of a Regulation which would have an effect of deregulating the designation of the Zone Pool, we have reconsidered the background and we do not think now that any particular action is involved either on our part or on the part of Union Gas Limited, other than to advise you that neither of us has any objection to the Lieutenant-Governor in Council issuing a Regulation to revoke the earlier Regulation under which Zone Pool was designated as a natural gas storage area. You may accept this letter as formal consent.

- Paragraph 9.; "Special Plugging Fund" whereby trust funds will be specifically tied to the wells for use in plugging and cleaning up the pipelines and such.
- Paragraph 10.; " Delete Article 15(C) of Lease" whereby the deletion disallows certain proprietary rights to the operator.
- Paragraph 11.; " Surrender of Old Leases" whereby the old leases are surrendered.
- Paragraph 12.; "Annual Well Payments" whereby well payments to the landowners of $500 are called for annually.
- Paragraph 13.; "No Depository" whereby he notes all landowners agree the payments should be paid direct to them.

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- Paragraph 14.; "Minimum Annual Royalty Payments" where in the minimum annual royalty payments to landowners will be $10 per acre.
- Paragraph 15.; "Test and Repair Pipelines" which addresses the landowner's concerns for the state of the pipeline on their property in regard to safety, escaping gas and the hazards to the environment.

Mr. Lawson was his frustration with the negotiations between landowners and the previous owners Mr. Gout and Lakeville. New leases were offered and then revoked, and face to face discussions were always confrontational. The landowners turned to the Ministry to enforce the pooling and plugging regulations which took considerable time to be acted upon. Other lease offerings were made after the new owners took over the company. He was displeased that Lagasco/Lakeville made lease offers to the individual lándowners and not the Zone Landowners Association.

The landowners consider the terms of the proposed leases, for the unleased landowners and the proposed overall unit operation agreement, are unacceptable. The landowners suggest lease arrangements negotiated by others [Ex. 2. Tab 16] to have greater acceptance with; initial payments of $6,000, rent at $30 per acre, delayed and suspended payments of $30 per acre, and a royalty of 12.5 percent. The landowners consider another lease [Ex.19 - Bluewater] clause, dealing with trust funds, whereby the operator has to place $30,000 in trust before drilling a well and pay a one time fee of $10,000 per well, to more acceptable.

Mr. Lawson agreed that a wide variety of leases are used in the industry and the landowner is expected to pay his share of transportation and compression fuel costs. Ontario leases cover a wide spectrum from the generous "Ranger lease", to the mid range "Union Gas lease", then the lower end "Romney Pool lease" and the lowest value one page "Norfolk County lease". He expressed concerns that the Applicant is relying on the Romney Pool application as precedence which was unopposed by the Respondents in that case.

The financial picture of Lagasco appears to have improved over the years and the management efforts are notable. The plugging efforts over the past few years have been satisfactory and meet the **Regulations**. Reflecting on Mr. Hewitt's testimony, he noted a slight relief knowing that if the demise of Lagasco happened the Ministry will go after the licence holder, the trust fund and previous operators to pay the plugging costs before the landowners are approached for the costs. However he expressed reservations that the Ministry will be slow to react during an actual event.

Mr. Lawson stated that a legal opinion should be required to determine the allowable drilling depths (horizons). The leases currently in place, are antiquate and likely invalid but are not being challenged. He expressed uncertainty that enough provisions exist to drill an off-target well based on the old leases and the lack of a pooling clause. No other operator is being suggested for the operation of the pool and the landowners do not prefer to be a working interest operator.

Submissions for the Application by Mr. C. Lewis, Counsel for the Applicant

Mr. Lewis submitted that the applications for a compulsory unitization order are being brought forward under subsection 8(2) of the **Act**. He referred to three issues provided in evidence, by the consultant, that: 1) no waste of the resource will result from an ordered unitization: 2) the unitization will ensure the ultimate recovery of the substances for over ten years and; 3) the order will ensure each of the parties their equitable share of the royalties from the unitized substances produced. Going forward with the unitization provides for a 12.5 percent royalty accruing to the landowners, pool expansion possibilities, meeting the general encouragement of unitization by regulators and providing benefits to all parties. The situation as it now exists makes achieving all these possibilities impossible.

Mr. Lewis cited past decisions by the Mining and Lands Commissioner that dealt with the purpose for unitization and quoted from the Lowrie Holdings Inc. - Romney Pool decision (2001)[10] which supports the applications for a unitization. Further the Unit Operation Agreement and the Petroleum and Natural Gas Grant/Lease presented in the application is consistent with those already ordered by the Deputy Mining and Lands Commissioner in the Romney case reference. Mr. Lewis noted excerpts from J. B. Ballem's book[11] and a booklet by the Office of the Mining and Lands Commissioner[12] further support unitization.

Mr. Lewis submitted that no pooling applications and no cross-applications with the particulars called for in section 14. of the **O. Reg. 245/97, amended by O. Reg. 22/00,** have been presented. The lease format presented meets the industry standards. The majority of the landowners have a lease registered on their property except for those identified. The leases will permit additional

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The purpose of unitization quoted in Lowrie Holdings Inc. et al vs. All the Leased Landowners in the Romney 6-11-1 Pool (December 12th, 2001) at page 14, submissions by Mr. C. Lewis; "...the purpose of the unitization is three-fold in that it promotes,; the conservation of oil, gas and unitized substances so as to prevent waste, ensures the ultimate recovery of the unitized substances and ensures that each party interest to the order obtains their equitable share of the unitized substances produced. An order for unitization will make this possible."

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Ibidem, at Page 179; "From an operational point of view it makes good engineering and economic sense to operate a field as an entity without regard to any artificial distinctions created by the ownership sub-divisions.", and at Page 185; "It is impossible to say anything against the principle of unitization. It undoubtedly achieves better operating procedures, enhances recovery, and implements good conversation practices, al at reduced cost. It is not surprising, therefore, to find that unitization is encouraged by public conservation bodies."

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Office of the Mining and Lands Commissioner - publication, Queens Printer, entitled; "Oil, Gas and Salt Resources Act, Document of Explanation" at page 7.; "The benefits of unitization to the operator include streamlined operations, centralized facilities, and a lower economic production limit due to lower operating costs and additional recovery of all oil or gas. The benefits of unitization to the landowners include a longer production life of the pool (more royalties), less surface production equipment and a guarantee of a share in production regardless of whether a well is located on their land or spacing unit. The latter benefit occurs since all production from a unitized pool is deemed to have come from all interest owners."

drilling, if required, at a future date and surface use in compliance with the Regulations will provide the protection as legislated. The unitization agreement will provide the necessary flexibility for the future. He stated that modifications and the adding of addendums to the lease is considered dangerous. The lease form and format has evolved through litigation and the provision changes. The modified form presented by the Respondents is unfair in many ways. The up front payment requested by the Respondents is inappropriate given that the up front payment is traditionally a negotiating incentive payment to convince unleased landowners to lease their lands.

The Respondents have not put forth technical evidence dealing with the interpretation or delineation of the unit area or participating areas. Mr. Lewis noted the Respondents testimony agrees with the consultant's interpretation of the unit area and the participating boundaries are established based on current evidence and technical information. The **Regulations** (sec. 22.) permit applications, on the matter of metering, for a deviation in certain circumstances and criterion.

Mr. Lewis submitted that the requirements of Subsection 15 (4) of **O. Reg. 245/97, amended by O. Reg. 22/00** have been complied with and referred to Subsection 15.(4) for clarity;

(a) January 1st, 2003 is the proposed effective date of this Order,

(b) The geographical and geological description of the unit area proposed is submitted and contained in Exhibit 1.(a) and 1.(b),

(c) The unit area plan outlining the boundaries, tracts and participating sections are contained in Exhibit 1.(a) at Tab 11 for Zone "B" Pool and in Exhibit 1.(b) at Tab 15 for the Zone "C" Pool.

(d) The summary showing the tract allocation of the oil and gas interests within the unit area is contained respectively in Exhibits 1.(a) and 1.(b) at Tab 16 for each.

(e) The copy of an oil and gas lease that governs the relationship between the working interest operator and any surface rights and/or mineral rights owners, who have not executed a Petroleum and Natural Gas Grant/Lease is respectively contained within Exhibits 1.(a) and 1.(b) at Tab 19 for each.

(f) The copy of the Unit Operation Agreement governing the relationship between the working interest operators and the royalty interest owners is contained in Exhibits 1.(a) and 1.(b) at Tabs 15 & 16.

(g) The proposed Initial Unit Operator is Lagasco Inc.

(h) Recommend no costs awards to either party, however the right to submit is pending submissions by counsel.

Mr. Lewis noted the balance of the items in the regulated format are either for the Commissioner's consideration or redundant for this situation.

This is an unfortunate set of proceedings that has produced fruitless negotiations over the past seven (7) years. Attempts have been made by both sides which have failed for a myriad of reasons. It is not the job of the Tribunal to lay blame for these failed negotiations. Acceptance of the proposed unitization agreements by the landowners could have negated the need for this hearing. However, without acceptance, the hearing process was necessary, as mandated by legislation. All parties are being heard on the issues.

Mr. Lewis submitted that the Respondents arguments are predicated upon the Applicant's financial solvency. There has been no evidence of insolvency since Jane Lowrie purchased the company from the Gout estate in 1999. The business operates as a going concern with a well plugging program in place which complies with the **Act**. Notably seven (7) wells have been plugged since the corporate take-over. The Respondent's argument on insolvency is weak and there is no evidence of it after 1999. In a worst case scenario (insolvency), which is not suggested here, there is the potential successor operator of the assets or the previous /prior operators to shoulder the plugging cost liability, as well as, reliance on the trust to pay the costs. Mr. Lewis paraphrased the evidence by Mr. Hewitt of the MNR noting that the trust referred to under section 16. has not been used for any defaulted obligations in the past 6 years and the Applicant is in compliance with the **Regulations**.

In regard to health and safety issues, Mr. Lewis noted that the Applicant is in compliance with the **Act** and that the Respondents did not provide any new evidence to the contrary. The **Oil, Gas and Salt Resources Act**, the **Regulations** and the Provincial Operating Standards all have safeguards to deal with the plugging cost issue. It is inappropriate for the Commissioner to embark on a police type mission and add provisions to any lease.

Mr. Lewis submitted that the system has an extensive code in place for the inspectors and the Ministry. The code, the **Act** and **Regulations** are confirmed/recognized within the standard provision of the Petroleum and Natural Gas Grant/Lease (clause 10);

> 10. CONDUCT OF OPERATIONS
> The Lessee shall conduct all operations on the said lands in a diligent, careful, and workmanlike manner and in compliance with the provisions of any statutes, regulations, orders or directives of any government or government agency or Commission applicable to such operations, and where such provisions conflict with the terms of this Lease such provisions shall prevail.

Mr. Lewis noted that the existing lease land relationship between the operator and the landowners is recognized as antiquated in terms of compensation. However, the lease and unitization terms proposed provide for a modern day 12.5 percent royalty. The Tribunal should accept and adopt the lease and unit agreements as presented and reject the extraneous clauses and pooling as set out by the Respondents. The royalty should be calculated in the normal fashion; after deductions for compressor changes or compressor gas and not "at the well head", as suggested. The costs to market is something that should be borne by both parties equitably. It is in everyone's interest to repair pipelines, get on with production and share in the revenue and benefits. The relationship is one of give and take and the operator doesn't want difficult relations with the Zone landowners. Opposing Counsel's recollection of the evidence is not completely accurate and his personal attacks on the witnesses in summations is considered petty. The evidence given by the expert witness and the company personnel is the preferred evidence on technical matters and something Mr. Lawson, for the Respondents, agreed with. The Applicant is in a position to get operations underway and produce royalty revenue resulting in compensation for the landowners.

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Submissions of Mr. J. Chinneck, Counsel for the Respondents

Mr. Chinneck submitted that the Respondents in this hearing are second generation farmers and landowners in Zone Township who have been exploited by the gas companies for over 60 years. The landowners agree with the joining of interests through a pooling agreement to protect their rights. They have tried to negotiate fair terms and gain the assurance that the liability to plug wells by the operating oil company will be taken care of in a timely manner.

The drafted agreements presented do not have adequate provisions for the security of the landowners interests and there is a real possibility that the abandoned wells can become the farmer's liability. There is nothing written in the agreements to cause the operator to operate safely and the operator, if not caused or ordered to operate safely, can create a risk to people in the area.

Mr. Chinneck submitted that the ultimate issue, is who will pay for a well abandonment/ plugging? The cost assumptions are calculated at $6,000 per well, but it is more likely the bill will be $17,000 for plugging cost. Based on the financial statements Lagasco is insolvent and the $17,000 plugging/clean-up bill can eventually be the farmer's liability. The calculations for the plugging costs for the total Zone wells ($677,000) and the present value information for the whole field (negative $162,000) indicates insolvency. It is the operator's liability this is at issue here and assurances should be included in the Mining and Lands Commissioner's Order to provide comfort for the landowners.

Mr. Chinneck submitted that the expert witness, Mr. Walsh, in his estimation, impressed as a hired gun writing a report in 2000 to persuade farmers to take a $3 per acre lease based on a bleak picture he painted. The older 2000 report showed an 8.5 percent decline rate, which depletes the field in approximately eleven years. The 2002 report, in contrast, shows a decline rate of 5 percent with a 20 year life for the field. The references are confusing and this application, to unitize, shows the field is not in its twilight years.

Mr. Chinneck submitted that Mr. Miller, President of the company, lacked general awareness of the Zone wells operations during questioning and appeared confused concerning well records. It is his understanding that this may be an offence under the **Act** at clause 19(1)(b)[13] and subject to penalties. Based on his observations, the Ministry and the landowners have doubts concerning the production volume accuracy and more importantly the landowners have to accept costs/charges based on the numbers and calculations provided by the operator.

Mr. Chinneck reflected on the company financial statements (1999) and Ms. Lowrie's testimony. She was not certain of where abandonment and capital assets cost were allocated in the statements. He provided calculations that the net equity in the statement of negative $1.35 million is possibly understated by 41.4 million or more when the potential liabilities are added in. He suggested Lagasco Inc. considered the landowners to be an insignificant nuisance.

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[13] Mr. Chinneck read from clause 19(1)(b) of the Act: "makes an offence to knowingly make a false statement or provide false information in a document or other form of communication required by the Act or by the Regulations."

He noted that Mr. Hewitt's testimony confirmed that the landowners have the ultimate liability for plugging and the plugging liability costs can affect the value of the properties. He noted that his testimony shed some light on the operation of the trust funds.

The landowners want a fair and modern lease similar to the "Range" lease presented into evidence. The Respondents are prepared to accept a compulsory unitization provided the lease schedule proposed by them is adopted and overrides the unit operation agreement. The Respondents require agreeable items such as; a $20 per acre initial payment, metering of each well, 12.5 percent royalty, drilling restrictions to A-1, A-2 horizon depths and no new wells drilled. Based on the Respondent's concerns with the accuracy of the company data, calculation of the royalties should be without deductions and fixed at 12.5 percent.

The landowners would like the old leases surrendered and replaced by their drafted modern version [Ex. 2, Tab 16]. A pooling order for the Zone "B" Pool is considered adequate considering the reservoir size which, in Mr. Walsh's words, is "thin and patchy". In reference to Ballem's rationale for unitization it appears that efficiencies are achieved at the outset of a field under development and not after the well infrastructure is built and in place.

The landowners have been treated poorly over the years being paid only $1 per acre by the previous operators (Union Gas and Lakeville). The current operator Lagasco has paid likewise and while reducing debts by $1 million paid the landowners only $20,000 over the same two year period. Past financial information (Union Gas) shows sales of $1.2 million from this field which at 12.5 percent would produce an approximate $150,000 royalty yearly however, the landowners received only $10,000. Based on the inadequacy of compensation to the landowners and the failed negotiations in the past, the Tribunal should consider a lump sum payment retroactive to 1996. He submitted that unitization of a 60 year old field is not appropriate while pooling is adequate allowing for the efficient and fair exploitation of the resources. Mr. Chinneck reviewed the lease from the previous Romney[14] decision by the Office of the Mining and Lands Commissioner noting that the lease ordered protects the operator and that application for unitization was unopposed.

Mr. Chinneck submitted that Counsel for the Applicant is suggesting the health and safety enforcement issues be governed by the standards and regulations set by the Ministry of Natural Resources not the lease terms. There is a serious risk of accident and/or fatality because it is his belief the Ministry is not enforcing the Provincial Standards and Regulations due to its serious manpower shortage and evidenced, according to Mr. Lawson's testimony, by landowner's telephone calls to Lagasco resulted in a slow reaction to problems detected in the gathering system.

There is no standard lease in the oil and gas industry and no lease that protects the Lessor. The documents have been drawn by industry, for industry, to protect their interests to exploit the resources. It is time for leases and the Compulsory Order to reflect some of the checks and balances the Respondents request, drafted with fairness and language that protects the landowners.

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[14] Romney 6-11-1 Pool, application for unitization; Lowrie Holdings Inc. et al v. All Leased Landowners in the Romney 6-11-1 Pool, December 12th, 2001

Mr. Chinneck agreed that the relationship has to have some give and take. The Order has to be a fair arrangement amongst the parties.

Mr. J. Chinneck submissions on Jurisdiction (special trust)

Mr. Chinneck submitted that the tribunal has the authority to grant provisions under subsections 8(1) and 8(2) of the **Act** that include a special plugging liability trust. It is his interpretation that subsection 8(2) allows for a "special plugging trust" to be included in the Order according to the phrase "costs and benefits of the drilling or operation be apportioned in a manner specific in the Order". Sections 14. and 15. of the **O. Reg. 245/97, amended by O. Reg. 22/00** stipulate at each paragraph (e); "a copy of the oil and gas lease that governs the relationship of the parties" gives the Tribunal the authority to include a new lease or change its terms within an Order. The Respondent's request for a special trust in the order is asking the Tribunal to act within its power under the **Act** and incorporate all the terms of the schedules proposed by the Respondents. The special trust funds are separate and identical to the trust funds already included under the **Act**.

Mr. C. Lewis submissions on Jurisdiction (special trust)

Mr. Lewis submitted that the power to impose additional trust is coercive. The trust obligations are covered by the **Act** and the **Regulations** and the provisions are very specific. It could change in the future, however the proper way to have any changes of this type occur is by way of legislative amendment. This has never been done before in this type of proceedings, both before the Commissioner and the Ontario Energy Board, and Mr. Hewitt confirmed it.

The **Regulations** (sec.16) provide for a trust that covers plugging costs therefore it is not necessary to duplicate it in the Order even if the Tribunal has the jurisdiction to do so.

Mr. Lewis submitted that Subsection 8(2) of the **Act** does not provide the authority to make an order which includes a provision for trust fund monies. Subsections 8(2)(a)(b) or (c) do not include the rights for the Commissioner to enlarge upon trust requirements. The **O. Reg. 245/97, amended by O. Reg. 22/00** (sec. 16) sets out the requirements under the **Act**. The authority of the Mining and Lands Commissioner within the **Act** is a statutory one, with no inherent jurisdiction. Mr. Lewis submitted that support for his claim is found in **Keable vs. The Attorney-General of Canada**[15] based on the principles involving administrative issues for Boards and Tribunals (at page 27, para. 41&42);

> Section 7 of the Provincial Act purports to confer upon a Commissioner," (Police Commissioner in this case) "...all the powers of a Judge of the Superior Court in terms, but this cannot make him a Superior Court, as this is something a provincial legislature cannot do by reason of Section 96 of the B.N.A. Act: see the recent judgement of this Court in A.G. Quebec v. Farah..." and further "The Commissioner does not enjoy the status of a Superior Court; he has only a limited jurisdiction. His

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[15] Keable v. Attorney General of Canada Et Al, 6 C.R. (3rd) 145, [1979] 1 S.C.R. 218, 43 C.C.C. (2nd) 49, 90 D.L.R. (3rd) 161.

> orders are not like those of a Superior Court, which must be obeyed without question; his Orders may be questioned on jurisdictional grounds because his authority is limited. Therefore his decisions as to the proper scope of his inquiry, the extent of the questioning permissible, and the documents that may be required to be produced, are all open to attack...", "Because a Commissioner has only limited authority he enjoys no inherent jurisdiction, unlike Superior Courts which have such jurisdiction in all matters of federal and Provincial laws unless specifically excluded. It is by virtue of this inherent jurisdiction that Superior Courts which have a general superintending power over federal as well as Provincial authorities, as held in the Three Rivers Boatman, (supra.). It is unnecessary to decide in the present case whether any possible attack against an Affidavit made under Section 41(2) of the Federal Court Act comes within the exclusive jurisdiction conferred upon the (Trial Division) of the Federal Court by Section 18 of the Act, because I find it clear that any jurisdiction for entertaining such an attack can only be found in a Superior Court."

Where jurisdiction of a Commissioner is created by Statute, there is no inherent jurisdiction.

Mr. Lewis submitted further support is found in the **CBC v. Cordeau**[16] at page 2;

> "...obtained its power from the Provincial legislation and has no inherent powers. To have the powers of a superior court, the members would have to be appointed pursuant to Section 96 of the British North America Act, 1867. The applicable provincial legislation only gives power to deal with contempt committed before the Commissioners."

and

> "Unlike certain courts of law the Police Commissioner has no inherent powers: it has only those powers which are conferred on it by statute."

There is no need to undertake a demonstration of this proposition, which seems neither disputed nor open to dispute. If there were any doubt on the point, it could be resolved merely by reading the observations of Pigeon J., speaking for the majority of this Court, in **A.G. Quebec vs. A.G. Canada.** Both the **Keable** and the **CBC** cases are clear on the principle of no inherent jurisdiction. The jurisdiction of this Tribunal is confined to the statutory provisions that provide its authority.

Mr. Lewis submitted that imposing a special trust provision by way of clause 15(4)(e)&(f) of the **O. Reg. 245/97, amended by O. Reg. 22/00** is not appropriate given that the provision is general in nature and the actual authority to provide an order is found within the **Act** at Subsection 8.(2). Further **Keable** case support is found at page 23;

> It is therefore clear that no provincial authority may intrude into its management. While members of the force enjoy no immunity from the criminal law and the jurisdiction of proper provincial authorities to investigate and prosecute criminal acts committed by any of them as by any other person, these authorities cannot, under the guise of carrying on such investigations, pursue the inquiry into the administration and management of the force. The doctrine of colourability is just as applicable in adjudicating on the validity of a commissioner's term of reference or decisions as in deciding on the constitutional validity of legislation." "You cannot do that which you are prohibited from doing directly."[17]

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[16] Canadian Broadcasting Corp. v. Cordeau, 14 C.P.C. 60, [1979] 2 S.C.R. 618, 28 N.R. 541, C.C.C. (2nd) 289, 101 D.L.R. (3rd) 24

[17] **Viscount Simon in; A.G. Sask. v. A. G. Canada**, [1949] A.C. 110 at 124,[1949] 1 W.W.R. 742, [1949] 2 D.L.R.145.

The Tribunal cannot do indirectly that which it is prohibited from doing directly. He submitted support from another Supreme Court of Canada case[18] (**CP Air**) concerning tribunal's authority and the Canadian Labour Code (section 121);

> ... a general provision which empowers the Board to make orders requiring compliance with the provisions of Part V - does not include a power to compel the production of documents outside the context of a formal hearing. The general provisions of the Code cannot be construed so as to give to the Board powers which are broader than those expressly and specifically provided for elsewhere. Since the power to compel the production of documents has been specifically treated in section 118(a), section 121 cannot be used to circumvent the special limits imposed on the power by that provision.

And at page 11,

> ...first, the general may not be interpreted so as to render unnecessary the other provisions setting forth the power of the Board, and second, the limitations inherent in the specific provisions, which detail with the powers of the Board, must be abided by if the intent of the legislature is to be respected. One of the issues in that case was the proper relationship between a broader, general provision, Section 121 of the Code, and the grants of powers made specifically elsewhere in the Code."
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> " It is quite possible that Section 121 covers only the powers necessary to perform the tasks expressly conferred on the Board by the Code, as Pratt, J. indicated. Nevertheless, I considered that even if it covers autonomous or principle powers, like that of ordering a reference to an arbitration, and not merely incidental or collateral powers, it cannot cover autonomous powers to design to remedy situations which the Code has dealt with elsewhere, and for which it has not prescribed specific powers, as is the case with unlawful strikes.[19]

Mr. Lewis submitted that there is a specific provision concerning the Tribunal's powers in Subsection 8.(2) of the **Act** and in the general provisions of **O. Reg. 245/97, amended by O. Reg. 22/00** on how the order is to take shape. The legislation provides for trust obligations under subsection 16 of the **Regulations** where it sets out the manner in which the trust is to be set-up, who will hold the trust, increments of the trust, etc. The **CP Air case**[20] at page 14 (para. 29) reinforces the aforementioned principles and in its conclusion offers;

> The extent of the power granted by section 118(a) of the Code appears from the plain meaning of the words of the provision. The Board may exercise its power to compel the production of documents, only in the context of a formal hearing. This conclusion is supported also by the fact that the nature of the power is coercive, and that the limits on its exercise must be respected. The fact that the power is also judicial in character makes extension of its application to an administrative context, one which would require clear words to that effect. The structure of the provision makes the power to compel the production of documents a part of a complete process which is limited to a formal hearing to which witnesses may be summoned and where they may give evidence on oath. The scope of section 118(f), which is permissive in nature. Similarly, the presence of broader provisions cannot here operate to allow the special limits imposed on powers such as this to be

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[18] Canadian Pacific Air Lines Ltd. v. Canadian Air Lines Pilot Assn., [1993] S.C.J. No. 114 (S.C.C.)

[19] Beetz J. ; Quebec et de L'Acadie v. Canada Labour Relations Board, [1984] 2 S.C.R. 412, at p. 432.

[20] Ibidem

> disregarded. As there is no basis for the conclusion that such a confinement of the power would be consistent with the purposes of the Board, when its administrative and judicial functions are considered, the power which is conferred on the Board by section 118(a) is a power to require witnesses to attend a proceeding before the Board and there to give oral or written testimony and produce documents deemed requisite. In these circumstances, the powers conferred on the Board by subsections 118(a) and 121 do not include a power to compel the production of documents outside the context of a formal hearing.

Mr. Lewis concluded that the tribunal's jurisdiction to order the special trust is deemed inappropriate.

Mr. Chinneck - cost award

Mr. Chinneck requested an award for costs based on the rationale of the failed negotiation history to get fair rents. He suggested that both the Applicant and the Respondent legal costs be combined and apportioned 12.5 percent for the Respondent's account/payment and 87.5 percent for the Applicant's account/payment.

Mr. Lewis - cost award

Mr. Lewis submitted that the Applicants hearing costs be considered based on the rambling nature of the evidence by the Respondents, as it unfolded, and the inexperience of the Respondent's counsel. It was his original approach that costs be borne by the parties for their own account(s). The usual circumstances for awarding costs is based on the criterion that; one party has acted unreasonably within the conduct of the hearing or, one party has wasted the Commissioner's time, or one party has been unreasonable and perhaps put in unnecessary evidence, or prolonged the hearing in some fashion. Counsel for the Respondent's, by his estimation, did not fall within the noted categories/definitions mentioned. He suggested the opposing Counsel's approach to costs seems to be based on wanting compensation for the landowners within awarded costs, which is, an inappropriate request of this hearing. The cost split suggested by the Counsel for the Respondents is unworkable and unrealistic. It is inappropriate to apportion fault or play catch-up in a relationship through the awarding of costs mechanism

Mr. Lewis submitted that expert testimony was presented by the Respondents and the applications were not dealt with on their merits. Either party can apply at any time for the combining and operation of the pools which is something Mr. Lawson intimated in past correspondence, but did not carry through with the request. Mr. Lewis concluded, requesting the Applicant's costs, in these matters, be assigned to the Respondents for payment.

FINDINGS

Purpose of the Act

In Ontario, the **Oil, Gas and Salt Resources Act** has evolved since 1990 undergoing various amendments throughout the period. Within today's **Act** there is a role for the Mining and Lands Commissioner, appointed under the **Ministry of Natural Resources Act**.

The **Act** does not contain a purpose statement and is therefore silent in this regard. However, upon examination of several Statute and regulatory sources, a determination of the purpose is evident.

In subsection 2 of the **Mining Act**, the legislation notably encourages exploration of mineral resources;

> 2. The purpose of the Act is to encourage prospecting, staking and exploration of the development of mineral resources and to minimize the impact of these activities on public health and safety and the environment through rehabilitation of mining lands in Ontario.

and within that **Act** is the definition of mineral which clearly supports a purpose for oil and gas exploration;

> "minerals" means all naturally occurring metallic and non-metallic minerals, including natural gas, petroleum, coal, salt,...

Generally, it can be concluded the purpose of the **Oil, Gas and Salt Resources Act** may be derived from the **Mining Act** and the provisions of subsection 8(1)(a) and (b) of the **Act** and the **Regulation** at clauses 14. and 15. These indicate clearly defined procedures to follow in the development of oil and gas resources.

Alternatively, rather than a clear directive stating the purpose of the **Act**, the tribunal is satisfied on the circumstances of this case that the underlying purpose of the legislation can be ascertained through a consideration of the consequences of discontinuing exploration. Specifically, if the exploration and production from under these lands were to cease altogether, the economic benefits to operators, employees, royalty interests and the economy overall would be negated. The purpose of the **Act** is evident through the various definitions and their references to the procedural applications for exploration and production of oil and gas.

While the foregoing discussion is by no means absolute in these matters, it is noted by the Tribunal that effectively Lagasco Inc. cannot produce from existing wells underlying the area without having this application to unitize granted.

Directives

The Tribunal finds granting a Compulsory Order under Subsection 8(2) of the **Act** is directed and influenced by the **Regulation** and the Provincial Policy Statement. These references are designed to standardize operations throughout the Province, protect the correlative rights of landowners, respect the way of doing business, and continue to trust in the industry's ability to evolve equitably.

The **O. Reg. 245/97, amended by O. Reg. 22/00** outlines the remedy for a stalemated voluntary unitization. Clause 8(4) of these regulations allows for an application for a Compulsory Order;

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> 8.(4) if an area is unitized by a voluntary agreement among the oil and gas interest owners within an area and the Minister agrees with the unitization, or if an area is unitized by an order of the Commissioner, the Minister shall revoke or amend any pooling conditions on licences for wells located in the unitized area, and may as the circumstances of the unitized area warrant...

The background and submissions presented herein indicate an obvious stalemate between the parties and a remedy is sought after herein.

There is clear direction provided for in the **Regulations** for consolidation efforts under unitization;

> 8.(3) No person shall,
> (a) drill a well in a spacing unit that has been pooled;
> (b) produce oil or gas from a spacing unit that has not been pooled;
> or
> (c) produce oil or gas from more than one well in a spacing unit.

The Tribunal takes further direction in providing an Order from the Provincial Policy Statement[21] at section 2.2.1;

> "Mineral resources (mineral aggregates, minerals and petroleum resources) will be protected for long term use."

and section 2.2.2.1;

> "Mineral mining operations and petroleum resource operations will be protected from activities that would preclude or hinder their expansion or continued use or which would be incompatible for reasons of public health, public safety or environmental impact."

and section 2.2.2.4

> "Extraction of minerals and petroleum resources is permitted in prime agricultural areas provided that the site is rehabilitated."

The Tribunal finds the spirit of the various sections of the policy is not being compromised by this Order for unitization. Unitization addresses protection of the resources for as long as it will sustain production. The Standards and Regulations address the needs for public and environmental safety. Further the Standards and Regulations address rehabilitation of lands after production ceases.

Merits of the Application

The Applicant focused their attention on submissions and testimony for a Compulsory Order for Unitization in compliance with **O. Reg. 245/97, amended by O. Reg. 22/00** (cl.15.) and put forward the argument that the field is best utilized within a Unit Operation Agreement.

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[21] **Order-In-Council 764/96** (May 8, 1996)

The Respondents, through submissions and testimony, presented their version of joining interests and new terms for their leases. They recounted considerable adversarial negotiating history for the Tribunal and argued for greater remuneration, fair terms and guarantees. In their arguments they laid down challenges to the Applicant's motives and decisions to produce from a "thin and patchy" gas field, the lessor/lessee relationship, and questioned the stability of the **Regulations** and Provincial Standards to serve the landowners interests.

The insight and questioning provided by the Respondents is appreciated by this Tribunal in considering the Order. The Tribunal finds the Respondents arguments lead to challenges of the core elements of the industry. Questions on the ownership of the oil and gas substances underground that surfaced in the Respondent's testimony, the Tribunal finds, are best explained through the industry root terms; "Rule of Capture" and "Correlative Rights". The Respondents appeared confused on mineral and petroleum substances ownership and while the logic of land ownership is not misplaced the interpretation of carbon substance ownership requires some clarification.

The ***rule of capture*** is an expression used extensively within the oil & gas industry. The Tribunal relies on several sources for discussion. In Ballem[22] where he writes;

> The "rule of capture", succinctly phrased by Hardwicke[23] is, "[T]he owner of a tract of land acquired title to the oil and gas which he produces from wells thereon, though it may be proved that part of such oil and gas migrated from adjoined lands," is firmly entrenched in Canadian Law in Borys v. Canadian Pacific Railway and Imperial Oil Limited[24], the Privy Council said:
>
> The substances are fugacious and are not stable within the container although they cannot escape from it. If any of the three substances is withdrawn from his property which does not belong to the appellant, but lies within the same container and oil and gas situated in his property thereby filters from it to the surrounding lands, admittedly he has no remedy.
> So also, if any substances is withdrawn from his property, thereby causing any fugacious matter to enter his lands, the surrounding owners have a remedy against him. The only safeguard is to be the first to get to work, in which case those who make the recovery become owners of the materials which they withdraw from any well which is situated on their property or from which they have authority to draw.

Also found in the case Kelley v. Ohio Oil Co[25] is a further explanation of the *rule of capture* relevant for our purposes herein;

> The right to acquire, enjoy and own property, carries with it the right to use it as the owner pleases, so long as such use does not interfere with the legal rights of others.

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[22] Ballem, John Bishop, The Oil And Gas Lease In Canada, 3rd. Ed., page 106, (Toronto: University of Toronto Press, 1999).

[23] Hardwicke E., The Rule Of Capture And Its Implications As Applied to Oil And Gas, 13 Texas Law Review, 391, 393 (1935)

[24] [1953] 2 D.L.R. 65, (1952-53) 7 W.W.R. (N.S.) 546, 550 (J.C.P.C.)

[25] Kelley V. Ohio Oil Co.; 57 O.S. 317, 327, 328 (1897).

> To drill an oil well near the line of one's land, cannot interfere with the legal rights of the owner of the adjoining lands, so long as all operations are confined to the lands upon which the well is drilled. Whatever gets into the well, no matter where it comes from. In such cases the well and contents belong to the owner or lessee of the land, and no one can tell to a certainty from whence the oil, gas or water which enters the well came.

Ontario supports the "Rule of Capture" whereby those substances found and taken into possession by the operator are within their ownership. While the surface rights are rightfully the landowners no ownership of the oil and gas laying under the lands exists until an operator has taken them into its possession. Ownership is clearly with the working operator.

The balancing rule for the landowners in this equation is the Legislation efforts to protect landowner's ***correlative rights***. The Tribunal finds that the issue of correlative rights of landowners is a core element of the petroleum industry and the protection of those rights have been argued extensively in law[26]. The Office of the Mining and Lands Commissioner has summarized terms used in this industry, in several printed pamphlets. The following explanation is quoted;

> The Correlative Rights[27] of landowners; means the inherent right of an owner of oil or gas in a pool to his share of the production and reservoir energy and his right to obtain his just and equitable share of production and to be protected from wasteful practices by others in the pool. The Protection of Correlative Rights of landowners is provided for by the Province under the **Act** in that it places requirements on the operators to drill and produce a well within the target area of a pooled spacing unit.

The statutes and regulations are written with respect for the correlative rights of landowners through spacing unit designations, reasonable set-back requirements and compensation methods. This unitization application has met the pre-conditions, with regard to the rights of interested parties, represented by four executed lease agreements with protective, continuation and royalty clauses contained therein. The tribunal finds the six landowner's correlative rights will be addressed and continue to be accounted for in the Unit Operation Agreement.

The matter of the existing lease validity was not raised as a direct issue in the hearing. However, it was questioned extensively in the hearing testimony. The Tribunal finds such matters rest properly between the parties to the agreements who may or may not elect to challenge the terms of such leases. The lease relationship is a contract and support for its basic princeples is found in Anson's Law of Contracts, 20th ed. (pp 1-2);

> The parties to a contract, in a sense make a law for themselves; so long as they do not infringe on some legal prohibition, they can make what rules they like in respect of the subject matter of their agreement, and the law will give effect to their decisions.

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[26] Ibidem, see Page 32 herein - Bory's v. Canadian Pacific Railway and Imperial oil Limited

[27] Oil, Gas and Salt Resources Act, document of explanation, page 4, authored by the Office of the Mining and Lands Commissioner, Queen's Printer f Ontario, printed in Ontario, Canada, 2000.

The older lease contracts with only basic elements recorded, relies on this theme. Further the principles of a basic contract is discussed by S.M. Waddams[28] ;

> ... there is nothing to prevent parties from entering into contracts on terms written out on half a sheet of notepaper...

Specific to an oil and gas lease contract, support can be found in Gallagher v. Gallagher[29]. The Court resolved;

> When such a "mineral lease" (profit a' prendre) has been granted and then protected by registration of a caveat, it cannot be defeated.

The Tribunal finds the lease effectively allows the parties to the lease to determine the terms and conditions which will govern their relationship. The Tribunal is aware that the leases of a majority of landowners can serve as the cornerstone for any Order. Numerous sources and cases in law influence the description of a Petroleum Oil and Gas Lease/Grant and it is generally accepted that it is a document "profit a'prendre" being more than a realty lease or an easement. This Tribunal dealt with the document in Gaiswinkler[30] previously and considers the lease recognizes ownership of the hydrocarbon substances, captured by the lessee, brought to the surface into their possession and inventory, provided they have a certified well licence and is the lessee of so much land held under lease for that purpose.

The Tribunal finds accepting the older leases as a basis for this Order does require some explanation. Some of the leases were founded in the 1980's with pooling clauses allowing the Lessee to effectively join the leased lands with other adjacent landowners. There are four leases continuing in effect and registered. There are salient passages within the lease(s) at each habendum clause which form continuation. Respectively they read;

> TO HAVE AND TO ENJOY the same for a term of ten (10) years from and including the date hereof and so long thereafter as the leased substances or any of them are produced from the said lands, subject to the other provisions herein contained.

and

> TO HAVE AND TO HOLD the said lands for and during the term of ten (10) years from the date hereof and as long thereafter as...said substances... are produced or recovered from the said land or as long as the Lessee conducts operations on the said land or any part thereof...

and

> ... and so long thereafter as any of the said substances is or are produced in paying quantities from the said lands and/or so long as the Lessee continues operations on the said lands...

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[28] S. M. Waddams, The law of Contracts, 2nd Ed., Aurora; Canadian Law Book 1984, pp 29.

[29] Gallagher v. Gallagher (1962-63) 40 W.W.R. 35 (Sask.); pp 770

[30] Gaiswinkler decision, December 3rd, 1999, Office of the Mining and Lands Commissioner, file OG 003-98, (unreported).

and

> ... do hereby grant and demise unto the said lessee, for the term of ten years and so long thereafter as oil or gas is produced in paying quantities, all the petroleum oil and natural gas...together with the exclusive right to carry on geographical research work and to drill for and remove said oil and gas...

and

> ... Lessor and Mortgagee grant to lessee the right to possession of so much land as shall be deemed necessary by the lessee to conduct operations for said purposes...

and in one instance a pooling clause;

> ...The Lessee is hereby given the right and powers at any time and from time to time to pool or combine the said lands...

The passages note continuation, specific to the performance criterion held within the lease agreements. The Tribunal finds that the parties agree, certainly at this moment, to continue the relationship and working the proposed unit for hydrocarbons.

The Tribunal's reference to the continuation clauses by no means determines their fate as a contract, that challenge is best left for the courts to decide. Further the Tribunal has heard no new arguments against the lease documents that would prompt the Order to include fresh leases for those currently under lease. The Tribunal is convinced by the Applicants submissions that the unitization agreement will address the concerns for the modernization of terms expressed.

The Tribunal finds it is not in a position to question or rule on a lease continuation based on the ongoing features of the lease. In any event, the jurisdiction for examining the validity of the leases properly falls under the jurisdiction of the Courts, should either/any party be inclined to raise a challenge. This Tribunal will be bound by Court decisions.

The Respondents challenged the Applicant's motive to explore and whether it is in their best interests to proceed on a minimum of geological information. The Tribunal finds that if the Lessee/operator is willing to risk its drilling investment with no onus or financial support required of the Lessor(s), then their sole determination and decision to satisfy the requirements for a licence to drill and produce hydrocarbon substances is sufficient.

This Tribunal finds the suggested term "commercially viable quantities", as well as, "found", "in producing quantities", "sufficient quantities" is or are relative to the industry root term "in paying quantities" which has been discussed extensively in law. Ballem[31] at pages 132 and 133 draws his conclusion;

> It would seem therefore that a Canadian Court forced with a reference to "producing in paying quantities" in the habendum would opt for revenue verses operating costs, and exclude the cost of drilling and equipping the well.

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[31] Ibidem, (3rd, edition)

and further in the case **Stevenson *v.* Westgate**[32];

> *Stevenson v. Westgate* stands for the proposition that a Canadian court forced with the test of 'producing in paying quantities', would opt for revenues versus operating costs rather than some other guideline such as whether a 'reasonably prudent operator' would continue to operate the well.

The decision to continue to explore and drill for hydrocarbons is for the risk of the operator.

The Tribunal is convinced the operator is not advancing their efforts based solely on determination. The historical records for the past yearly gas volumes of between 2300 (10-3-M3) and 5800 (10-3-M3) submitted prior to 2000 gives them some comfort for their decisions.

The Respondents put forward text alternatives and alike modern industry terms in their attempt to negotiate better lease agreements. The Tribunal finds the Applicant's drafted unit operation agreement serves to address the expressed concerns of the Respondents in terms of; royalty percentage to be paid out, plugging liability conditions, continuation of the relationships and defining boundaries. The Tribunal notes the draft unit agreement includes fair and modern concepts and support for the modernization efforts is found in Ballem[33] ;

> (pp. 218-219)
> Effect of Unitization
> The model agreement provides that, upon the interests of each royalty and working interest owner being unitized, the unitized zone shall be treated as though it had been included in a single lease executed by the royalty owners as lessors and by the working interest owners as lessees and as if the lease had been subject to the unit agreement. This is the fundamental effect of unitization, and thereafter individual lease boundaries may be disregarded for operational purposes.

and

> (pp. 222)
> Amends the Lease
> the unit agreement substantially changes the terms of any lease. In Alminex Limited v. Berkley Oil and Gas Ltd.[34] It was held that unitization only amends a lease to the extent it was specifically provided for in the contractual terms. Presumably to overcome this limitation, a clause in the unit agreement provides that each lease is amended to the extent necessary to make it conform to the agreement.

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[32] [1941] 2 D.L.R. 471 (Ont. S.C.O.), [1942] 1 D.L.R. 369 (C.A.)

[33] Ibidem; Ballem (3rd Edition).

[34] [1971] 4 W.W.R. 401 (Alta. S.C., T.D.); [1972] 6 W.W.R. 413 (Alta. S.C., App. Div.), Aff'd (1974), 1 WWR 288 (S.C.C.).

> (pp. 222)
> Lease Ratified
> By executing the unit agreement a lessor, unless a court action has been commenced or is pending, ratifies and confirms the lease and agrees that no default exists with respect thereto and that the lease is in effect. Since the lease itself requires execution under seal and the unit agreement purports to amend and ratify the lease, the agreement should also be under seal.

Further questioning of the regulations and the motives behind rules and standards was raised by the Respondents. The Tribunal finds it does not have the power of the Ontario Legislature in such matters nor is it empowered to offer suggestions as to the Statutes and Regulations make-up as the Respondents suggest. The scope of the Tribunal's task is to entertain applications providing a remedy for the joining of interests and protecting the various interests.

Lease Proviso

The subject of the Petroleum and Natural Gas Lease(s)/Grant(s) drew considerable discussion and submissions. The relevance to this application can be identified in two distinct references. First the lease as a continuing contract and secondly maintaining the landowners correlative rights. The continuation of the current executed and registered Petroleum and Natural Gas Lease(s)/Grant(s) is upheld by the Tribunal as referenced previously above. The Tribunal finds that no replacement leases nor changes to the existing executed leases is needed.

The Tribunal finds that this application provides for the unit operation agreement to protect the rights of the Lessors. Pursuant to subsection 8(2)(a) of the **Oil, Gas and Salt Resources Act** this Tribunal finds protection of the correlative rights of two parties is both necessary and in order. The 95.23 percent (approx. 379.77 acres) majority of the said lands is under lease agreement to Lagasco Inc. The total area of the Unit (6 tracts) is approximately 398.77 acres. The addition of the lands owned by Christopher and Della Marie Lovell (Tract 3) and Roger Cecil Oliver (Tract 4) will complete the boundaries of the unit area as described. These two properties in total consist of 19 acres or 4.77 percent of the unit acreage and will not be initially included in the participating area. The two leases will affix the relationship of Lessor and Lessee upon the registration of this Order.

The two ordered lease documents will be deemed effective on Wednesday January 1st, 2003 in advance of the Compulsory Order for unitization being made effective on the same date.

The duration of the lease(s) shall be for a period of approximately 5 years from January 1st, 2003 through to December 31st, 2007. Notably the habendum(s) clause is as follows;

> TO HAVE AND ENJOY the same for a term of Five (5) years (herein called the "primary terms") commencing on the date hereof and continuing so long thereafter as operations (as hereinafter defined) are conducted upon the said lands, the pooled lands or the unitized lands, with no cessation, in the case of each cessation of operations, of more than 90 consecutive days.

It is noted that this clause accepts the current industry norm whereby the Lessee is protected from termination of the lease(s) if drilling and or production are underway at the close of the term and this continuation will be duplicated in the supporting unit operation agreement.

The Respondents and their Counsel challenged the inclusion of the properties, through testimony, on the grounds that the lands will be totally non-participating. The Tribunal accepts the spacing fabric laid down by the Ministry for the area and finds the boundaries are within those guidelines. While the lands may be non-participating at the outset of this unitization as things progress they may well come into play as the field is assessed. In addition, the landowners directly affected will receive their due entitlement through unit management filings and notice rather than having to address a future tribunal on the matters.

The Respondents through Mr. Lawson's testimony are attempting to re-write and supercede the original leases and have them placed within this Order. The Tribunal respects their efforts to resolve the issues as they understand them to be. The discussion of certain clauses and suggested alternatives is a healthy exercise.

Unitization Agreement proviso

The direction of a compulsory order is governed by the **Ontario Regulations 245/97, amended by O. Reg. 22/00** under clause 15. The Tribunal is satisfied the Applicant followed the general format in filing this application. Further the tribunal considers the origin of the drafted unit operation agreement can be found in the CAPL[35] version of the document.

The Office of the Mining and Lands Commissioner has adopted a format for orders which takes direction from its predecessor the Ontario Energy Board in these matters. The ordered leases for the two landowners will be affixed respectively to each of their Compulsory Orders, as well as, those current leases with the Lessors of record. This is considered by the tribunal to be a precursor to the provisions set down under the Unit Operation Agreement.

Pursuant to clause 15(4)(b) of the **Regulations** the Tribunal establishes the unit boundaries within the Order. The tribunal accepts the boundary description as submitted in the application. No new evidence was presented that will alter the Unit boundaries from the drafted description provided.

This Order effectively joins the interests of six (6) landowners with the working interests of Lagasco Inc. to allow for the continuation of the wells, exploration and production.

The Respondents opposed the unitization order and offered an alternative pooling arrangement. The Applicant argued the unitization effort is the most efficient method for this aging pool. The Tribunal finds placing another step in the amalgamation of interests for the said lands efficient operations, given the Provincial policy and regulations, has no purpose. The alternate elements introduced by the landowners are considered addressed in the Unit Operation Agreement. They expressed concerns with the wording of the unitization document. The Tribunal finds that the

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[35] Canadian Association of Petroleum Landsmen (CAPL)

Unit Operation Agreement is industry significant and considers it to be ***Contemporonea Exposito Est Optima Et Fortissima In Lege*** [L.] *the current meaning is the best and most compelling influence in law.*[36]

Regarding continuation the habendum clause of the Unit Operation Agreement will continue the spirit of the leases;

> AND WHEREAS for the purposes of protecting the Zone "B" Pool from unnecessary and wasteful drilling and depletion, and for the protection of their correlative rights therein, the parties hereto desire to amend the said Lease and <u>to unite and combine</u> that portion of the said lands...

The Respondents voiced their concerns with remuneration. They agreed the 12.5 percent royalty offered for this depleted field, is adequate, but less than other arrangements researched. The Tribunal finds the Unit Operation Agreement modernizes the way of doing business, being both fair and modern. The royalty offered, while arguably less than the eighteen percent cited, is still considered to have wide-spread acceptance in the Ontario region. Efficient operations, in the Tribunal's mind, also includes economically feasible operations and increasing royalties by approximately sixty percent, as the Respondents suggest, may prove to be burdensome and create the alternative worst result, no production. No definitive answer can be assigned the economic viability of the field. However, the Applicant put forward a convincing argument that consolidating operations and coupling operations within a larger shell of operation makes the field viable. Alternatively, continuing with individual well production may not be commercially viable. Which would deprive the public of the use of the natural gas, as well as, the loss of income and jobs.

The Tribunal finds that adding a general compliance clause to the Unit Operation Agreement is in order. A clause noting the compliance with statues, regulations and the **Act** is usually found in the lease agreements however, upon review of the agreements, it is clear in one lease and not so in another. The Tribunal considers it would be prudent to include the following clause in the Unit Operation Agreement;

> The parties to this agreement recognize that the terms of this Unit Operation Agreement may be modified or affected by statute, regulation, order, or directive of any applicable government or government agency.

The Respondents will find this clause particular to their plugging liability and assurance concerns. To order an absolute plugging guarantee in all probability is an impossibility whereas recognizing liability will provide some degree of comfort. In any event, the operating party (lessee) is deemed to know the regulations and standards they are licenced under by the Ministry and the **Act**. The rules are clear.

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[36] The Dictionary of Canadian Law, (Carswell, 1991)

Within their alternative wording the Respondents suggested limits to surface and drilling rights. The Tribunal finds that the three paragraph reference flies in the face of Provincial regulations/standards and the process currently legislated for an oil and gas operator. Inclusion of these references is deemed not warranted.

The Mortgage Holders are named as Respondents of the Third Part. The Tribunal finds the Mortgage Holder is not bound by the Compulsory Order and no order is made upon them. Their position is immaterial to the unit operation agreement however they may elect to take up an "interest" position in the event of a debtors contract default. They are not deemed to be a party to these proceedings.

This application is based on the unitization of a field. The Tribunal finds where developed fields are expected to be small in volume it makes sense to combine an area to make it commercially viable and also eliminate the need to address the Commissioner again on this issue.

The industry has created the unitization method which can resolve/correct past situations that are not viable in today's terms. This method does not extinguish past agreements, but addresses equality and benefits in a modern day document. The Tribunal is reluctant to order a lease relationship where one currently exists, whether it is on one piece of note paper in Chaucer's good English or speaks volumes in Webster's modern language. The industry views these contract documents as continuing and the Tribunal is convinced the unit operation agreement addresses the industry intentions.

The unitization of the lands, while agreed to generally, is questionable as to its appropriateness in this case and the alternative of "pooling" is suggested by the Respondents. In addition, Counsel for the Respondents argued that unitization is not as effective for old field formations such as Zone with established infrastructures. He argued that Ballem, a credible reference herein, also agreed. The Tribunal follows Ballem's argument for unitizing new gas field exploration however, in this instance, this field, as well as others in the Province of Ontario are both old and depleted. In this case the pools where founded in the early 1900's and perhaps should have been unitized then. The Tribunal finds to use Mr. Ballem's statement for the purpose of opposing an application for unitizing is without merit. The Tribunal takes the approach that much of Ballem's written statements support unitization of gas fields, something that is considered long overdue for the Zone fields.

The Tribunal has taken its resolve in discussions favouring unitization from Ballem's book[37] at page 179;

> From an operational point of view it makes good engineering and economic sense to operate a field as an entity without regard to any artificial distinction, created by the ownership subdivisions.

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[37] Ibidem, (2nd Edition)

and at page 185;

> ...Once a lease is included in a unit by the lessor executing the unit agreement, and all operations anywhere within the unit have the effect of continuing the lease in force.[38] Moreover, the entire lease and not just the unitized zone will continue. This is the only result that is consistent with the wording of the lease and it has also received judicial sanction in *Voyager Petroleum Ltd. v Vanguard Petroleum Ltd.*[39] It is not surprising that unitization has grown increasingly popular with each passing year. It has become almost the rule with respect to gas fields and is normally completed before production commences. The trend to unitize oil fields is steadily growing.
>
> It is impossible to say anything against the principle of unitization. It undoubtedly receives better operating procedures, enhances recovery, and implements good conservation practices, all at a reduced cost. It is not surprising, therefore, to find that unitization is encouraged by public conservation bodies. In the purely private area of contract between the lessor and lessee, different factors may come into play. Under current industry practice the lessor is expected to execute a unit agreement without any additional consideration, the benefits described above evidently being regarded as sufficient incentive.

The Tribunal finds the above statement is a specific and supporting reference to this application.

The Tribunal offers caution to those relying on that which has been ordered previously in regard to compulsory orders. Caution should be taken where; the **Act** and the **Regulations** have changed from one order date to another and new evidence is presented that may alter the scope of a new Order. Also the changing practices of the Canadian Association of Petroleum Landsmen within the industry itself may call for quite another outlook in a future decision.

Jurisdiction to Order - Trust (plugging wells)

The Tribunal ruled in preliminary proceedings for this hearing that arguments for and against the ordering of a special trust served a purpose for this application hearing.

The Respondents argued that the Tribunal's Order should include a special trust provision to cover the well plugging liability. Their argument centered on assuring guarantees are mandated on the operator within the Order. They submitted that the Tribunal has the authority to alter and include terms of a unit agreement under the **Act** [8(2)] and the **Regulation** [cl.15].

The Applicant opposed the special trust and cited various precedents in law which prohibit the Tribunal from making such changes to the agreement and including them in the Order. Counsel for the Applicant noted the trust conditions of the drafted agreement address the trust as regulated (**O. Reg. 245/97, amended by O. Reg. 22/00**).

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[38] Esso Resources Canada Limited v. Pacific Cassiar Ltd. (1984) 22 Alta. L.R. (2d) 175 (Alta. Q.B.).

[39] [1982]

The Tribunal finds that the Ministry has adopted requirements for a Trust of $70,000 per operator through due process and legislation. The Ministry has legislated regulations for a trust which appears to meet current demands. The Respondents suggested wording changes for plugging assurances. The Tribunal finds the issue of plugging costs is dealt with in the **Regulations** under subsection 16.(1);

> Every operator of a well shall establish security,
>
> ...
>
> (b) in the form of a trust fund administered in accordance with the *Trustee Act* for the purpose of financial assurance that wells will be plugged and works completed in accordance with the Act and regulations and any order of the Board or the Commissioner. O. Reg. 245/97, s.16(1).

The Tribunal finds for this application that clause 16.(1) of the **Regulations** is adequate and no new evidence was presented that discounts it. The arguments for and against a special plugging trust where enlightening and most welcome. All concerns were heard. In hindsight the discussions did not weigh in the decision to Order.

Costs

The Tribunal finds that there will be no costs payable by any party with regard to the processing of this application and the resulting Order. The Tribunal finds arguments by Counsel, for the awarding of their costs, were unconvincing.

Salient to this position is the reward approach by Counsel for the Respondents and the change of decision by Counsel for the Applicant. The Respondent's Counsel argued an award should be made based on the past failed negotiation efforts of the landowners. This argument the Tribunal finds is not reasonable or significant enough for an award of costs. The Applicant's Counsel provided a change of mind request for payment of costs, adopting a superimposing approach. Neither party projected a genuine case for awarding costs, lacking docket and cost summary evidence to validate their claims.

Conclusion

For the reasons stated herein, the application will be granted with the various modifications and additions to the Unit Operation Agreement as noted herein. Effectively, the unit is ordered and shall include; a Petroleum and Natural Gas Lease/Grant(s) for two unleased landowners in the unit, and a compulsory order is issued for six landowners to enter into a Unit Operation Agreement described as the Zone "B" Pool.

The Tribunal respects and appreciates the testimony of witnesses and the submissions of Counsel. The tribunal notes the Compulsory Order is being made with due consideration of all submissions, exhibits and testimony.

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Schedules:

"A" Unit Boundaries - Legal Description

"B" List of Unleased Landowners

"C" Petroleum and Natural Gas Lease/Grant(s)

"D" Unitized Landowners and Allocation Schedule

"E" Unit Operation Agreement