**File No. 1565**
**Board Order # 1565-3**

**May 12, 2010**

**MEDIATION AND ARBITRATION BOARD**

IN THE MATTER OF THE PETROLEUM AND NATURAL GAS ACT, R.S.B.C., C. 361 AS AMENDED

AND IN THE MATTER OF
SW 29-84-21 W6M PID 011-099-224,
SE 31-84-21 W6M PID 044-384-148
(The "Lands")

BETWEEN:

Terra Energy Corp.

(APPLICANT)

AND:

Rhyason Ranch Ltd.

(RESPONDENT)

**BOARD ORDER ON RECONSIDERATION**

Heard by way of written submissions closing April 30, 2010.

Rick Williams, Barrister and Solicitor, for the Applicant
Shawna Specht, Barrister and Solicitor, for the Respondent

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## INTRODUCTION AND ISSUE

[1] By decision rendered March 4, 2007, following arbitration proceedings, the Board gave Terra Energy Corp. (Terra Energy) the right to enter, occupy and use Lands owned by Rhyason Ranch Ltd. (Rhyason Ranch) for the construction and operation of wellsites and an access road, and determined the amount of compensation payable by Terra Energy to Rhyason Ranch for the entry, occupation and use of Rhyason Ranch's Lands. By decision rendered January 14, 2008 (the Costs Decision), the Board determined Rhyason Ranch's entitlement to costs of the arbitration and ordered Terra Energy to pay Rhyason Ranch $5,767.00 in costs.

[2] Rhyason Ranch now asks the Board to reconsider its Costs Decision on the basis that there has been a change in circumstances since the Board made its decision. The change of circumstance is that on April 7, 2008, subsequent to the Board's decisions granting a right of entry, determining compensation for entry, and determining Rhyason Ranch's entitlement to costs, the Oil and Gas Commission (OGC) denied Terra Energy's application to construct an access road to the proposed wellsites on Rhyason Ranch's land. Rhyason Ranch submits that because of this change in circumstances, the Board's Costs Decision should be reconsidered and the award of costs should be increased. Terra Energy submits the circumstances do not warrant an increase to the costs award and submits that the application for reconsideration should be dismissed.

[3] Section 26(2) of the *Petroleum and Natural Gas Act* (*PNGA*) provides that the Board may review, rescind, amend or vary an order made by it. The issue is whether the Board should, in the circumstances, exercise its discretion under section 26(2) of the *PNGA* to vary its order for the payment of costs to Rhyason Ranch by Terra Energy.

## BACKGROUND

[4] In early 2006, Terra Energy began considering options for the construction of its wells. Terra Energy initially intended to drill the wells on neighbouring property to the Rhyason Ranch Lands. Terra Energy approached the owner of the neighbouring property but he was not willing to allow Terra Energy access to his property or to discuss the issue. In late March of 2006, representatives of

Terra Energy met with Mr. Rhyason, the principal of Rhyason Ranch, and his representative. Mr. Rhyason suggested that Terra Energy construct an access road on his land rather than the neighbouring land. On the basis of this suggestion, Terra Energy proposed the location of two wells and an access road on the Rhyason Ranch Lands. The location of the road and wellsite were agreed in general terms, with Terra Energy agreeing to avoid the residence and ranch headquarters.

[5] Mr. Rhyason and Mr. Dunn, Terra Energy's land agent, had a further conversation in April 2006 and by letter dated April 21, 2006, Mr. Dunn wrote to Mr. Rhyason setting out compensation rates. Being unsatisfied with the rates proposed, Rhyason Ranch wrote to Terra Energy indicating Rhyason Ranch would allow entry subject to various conditions including terms of compensation and that the construction work for the road and wellsites would be done by Rhyason Contracting Ltd., an affiliated company owned by Mr. Rhyason. On May 3, 2006, Terra Energy responded indicating that while they were prepared to continue negotiating the terms of access, in view of the terms suggested by Rhyason Ranch, they would refer the matter to the Board. Mr. Rhyason responded by letter of May 23, 2006 and suggested the parties meet to discuss conditions of entry. A telephone call was set up for May 31, 2006. Mr. Rhayson did not participate. Mr. Beatty of Terra Energy wrote to Mr. Rhyason expressing the view that Rhyason Ranch's conditions were "in excess of the norms and practices of industry and landowners".

[6] By letter dated June 15, 2006 Terra Energy served Rhyason Ranch with a copy of its application to the Board. The Board received Terra Energy's application on June 27, 2006. The Board conducted a pre-hearing telephone conference on July 19, 2006 and an in person mediation on August 28, 2006. The Board granted Terra Energy right of entry to the Rhyason Ranch Lands for the sole purpose of conducting a survey and referred the matter to arbitration. At Mr. Rhyason's request, Terra Energy agreed to hold off conducting a survey until after November 22, 2006 to accommodate the hunting season, and the parties agreed the arbitration would not proceed until after that date.

[7] The Board conducted a pre-hearing telephone conference on October 12, 2006 and scheduled the arbitration for January 23, 2007. The Board made various other procedural orders relating to the conduct of the arbitration and the delivery of statements of points and witness lists in advance of the arbitration. Terra Energy filed its Statement of Points by December 22, 2006 in accordance with the Board's order.

[8] On January 9, 2007, the Board received an application from counsel "in the process of being retained" by Rhyason Ranch seeking an adjournment of the arbitration. By letter dated January 11, 2007, the Board denied the request. Counsel for Rhyason Ranch renewed the application to adjourn the arbitration on

January 16, 2007 and by decision dated January 18, 2007, the Board again denied the request. For the first time in these proceedings, the letters seeking an adjournment raised the possible need for an environmental impact study.

[9] Rhyason Ranch provided written submissions approximately two weeks in advance of the scheduled arbitration objecting to the proposed route for the access road and proposing an alternate route using, for the most part, public access to the south of the Rhyason Ranch Lands, and a much smaller portion of the Rhyason Ranch Lands.

[10] The arbitration proceeded on January 23, 2007 and continued on January 24, 2007. The Board rendered its decision on March 4, 2007 (Order 403A) granting the right of entry for the access road and wellsites and determining the compensation payable. Rhyason Ranch filed a Petition for judicial review of the Board's decision on May 4, 2007. The parties agreed to adjourn the judicial review pending conclusion of the OGC's processes with respect to Terra Energy's applications for permits to construct the access road and wellsites. The Petition has not been heard.

[11] Rhyason Ranch sought costs of the arbitration in the amount of $44,088.61. By decision rendered January 14, 2008, the Board ordered Terra Energy to pay costs to Rhyason Ranch in the amount of $5,767.00 (Order 403C). Rhyason Ranch asked the Board to reconsider the Costs Decision and by letter dated February 13, 2008, the Board declined to exercise its discretion to reconsider the Costs Decision. Rhyason Ranch filed a Petition for judicial review of the Board's Costs Decision on March 11, 2008. The Petition has not been heard.

[12] On April 7, 2008, the OGC denied Terra Energy's application to construct the proposed access road through the Rhyason Ranch Lands.

[13] Rhyason Ranch made this application on January 5, 2010 asking the Board, once again, to reconsider the Costs Decision. By letter dated January 22, 2010, the Board agreed to conduct a reconsideration on the basis that there had been a change in circumstance since the Board's Costs Decision. In consultation with counsel for the parties, the Board set out a timeline for the provision of affidavit evidence and written submissions.

## SUBMISSIONS

[14] Rhyason Ranch argues that the Costs Decision should be reconsidered and the costs payable to it increased because the route of entry authorized by the arbitrator was rejected by the OGC. Rhyason Ranch characterizes the route of the access road as the "central subject matter in dispute" at the arbitration and submits that the costs incurred were directly related to this issue. Rhyason

Ranch argues further that Terra Energy has never sought to construct the wellsites for which it was granted entry and, as such, the compensation ordered by the arbitrator has never been paid. Rhyason Ranch submits the costs awarded were significantly below actual costs incurred and that it continued to incur legal fees before the OGC. It provides unredacted copies of the accounts originally submitted in support of their initial claim for costs, which was largely disallowed by the arbitrator for failure to provide adequate supporting documentation, among other reasons. Rhyason Ranch submits Terra Energy should have applied to the OGC before making an application to the Board and that, if it had, an arbitration would likely not have been needed. Rhyason Ranch submits it should be awarded costs of up to $48,000 which is comparable to both the actual costs expended by Rhyason Ranch at the arbitration and the compensation both the arbitrator and Rhyason Ranch anticipated would be received.

[15] Terra Energy disagrees that the "central issue" between the parties at the arbitration was the route for the access road although it agrees that much of Rhyason Ranch's time and evidence at the arbitration was focused on the routing of the access road. Terra Energy submits it was the unreasonable positions advanced by Mr. Rhyason with respect to compensation for access that necessitated the arbitration. It disputes that an arbitration could have been avoided if the route had been determined in advance because of Mr. Rhyason's positions on compensation. In any event, Terra Energy submits that as the OGC was not willing to entertain an application without either a surface lease or entry order being in place, Terra Energy had no choice but to apply to the Board before applying to the OGC. In any event, Terra Energy submits the route issue did not arise until two weeks before the arbitration and that, until then, the disagreement between the parties was essentially with respect to compensation. Terra Energy submits further that the OGC's decision was based on an environmental report obtained after the arbitration and not available to the arbitrator. Terra Energy submits that it would have preferred to submit to the OGC process first, and that it too has incurred considerable costs in relation to this matter. Terra Energy submits that much of Rhyason Ranch's submissions attempt to reopen the whole proceedings and challenge the efficacy of both of the arbitrator's decisions and are improper in the context of a reconsideration of the Costs Decision on the basis of a change of circumstances.

[16] Both parties accuse the other of having been unreasonable throughout.

## ANALYSIS

[17] I have reviewed the submissions provided for this reconsideration, the submissions originally provided to the arbitrator in the costs application and the Board's decisions. Circumstances have changed since the Board made its Costs

Decision in that the proposed route for the access road, for which the arbitrator granted right of entry and determined compensation, was not approved by the OGC. The issue is whether this change in circumstances should cause the Board to exercise its discretion to vary the Costs Decision to increase the amount of costs payable to Rhyason Ranch. Essentially, the issue is whether as a result of the change in circumstances, Terra Energy should bear greater responsibility for the costs incurred by Rhyason Ranch throughout these proceedings.

[18] This reconsideration is not an opportunity for Rhyason Ranch to reargue findings of the arbitrator not relevant to the change in circumstances. If Rhyason Ranch is of the view that the Board has erred with respect to any of those findings, its remedy is to pursue the judicial review, the Board having previously declined to exercise its discretion to reconsider the Costs Decision prior to the change of circumstances.

[19] I have reviewed the arbitrator's costs award with a view to assessing whether and how the "route issue" played into the award that he made in order to determine whether the change in circumstance should result in an increase to his award. After reviewing some general principles with respect to costs, the arbitrator found, at page 12-13, "that the Board's costs awards must be guided by principles that include the following:

1. Generally costs must provide partial indemnity to the surface rights holder for reasonable and necessary representational costs, including legal fees and disbursements, in connection with the application;

2. However, those costs must also encourage parties before the MAB to make reasonable offers to settle their disputes, encourage them to narrow the issues in dispute, and discourage improper or unnecessary steps in the litigation."

[20] In applying those general findings to the circumstances of this case, the arbitrator reiterated the three main issues before him in the arbitration, at page 13, as follows:

"1. Whether right of entry should be denied because of Terra's alleged failure to negotiate in good faith prior to applying to the Board;

2. Whether right of entry should be denied because Terra failed to show that its proposal, in particular the proposed access road, was the most appropriate for the Lands; and

3. Determining compensation and terms for the right of entry."

[21] With respect to the second issue, the arbitrator said at page 13-14:

> "Rhyason Ranch emphasized the regulatory failings of Terra's application seeking to have the application dismissed, rather than the compensatory aspects. The regulatory aspects are outside the jurisdiction of the MAB and within the jurisdiction of the Oil and Gas Commission. In its evidence and argument, Rhyason Ranch focused on the failings of Terra's proposal based on considerations that included financial, construction conditions, environmental and geotechnical grounds."

[22] It was the OGC's responsibility, not the Board's, to assess the proposed route from a regulatory perspective. The Board's decision to grant right of entry to Terra Energy did not, and could not, sanction the proposed route from a regulatory perspective and was always subject to the requisite permits being issued by the OGC. The possibility that the OGC would not permit an installation for which right of entry was granted was always present.

[23] In the arbitration decision itself, while finding that Terra Energy did not have to demonstrate to the Board that the proposed route was "the most appropriate route", only that Terra Energy had the onus to "establish its right to enter onto the Lands", and in finding that Terra Energy was entitled to the right of entry order, the arbitrator was mindful that the regulatory concerns with respect to the proposed route were not within the Board's jurisdiction and that much of Rhyason Ranch's evidence and argument was misdirected. The arbitrator was mindful that the Board did not have jurisdiction to assess much of the evidence and argument that Rhyason Ranch presented with respect to the proposed access road. The fact that the OGC ultimately did not approve the route proposed by Terra does not make the evidence and argument presented to the Board any more relevant to the issues before the Board in the arbitration.

[24] One of the general principles that the arbitrator considered in determining the amount of costs payable was that costs should encourage parties to make reasonable offers to settle their disputes, encourage them to narrow the issues in dispute, and discourage improper or unnecessary steps in the litigation. A review of the record and the affidavit evidence in this application discloses that it was not until two weeks prior to the scheduled arbitration that Rhyason Ranch took serious issue with the proposed route for the access road. Prior to that time, Rhyason Ranch's concern with the access road centred on its request that the access road avoid the residence, something to which Terra Energy agreed. Throughout the early discussions between the parties, Rhyason Ranch was agreeable to having Terra Energy enter the lands, and was generally agreeable to the route for the proposed access road. In fact, the suggestion to access the wellsites through the Rhyason Ranch Lands came initially from Mr. Rhyason. Mr. Rhyason's conditions for the access, expressed in correspondence both before and after proceedings were commenced before the Board, did not primarily relate

to environmental issues, concerns about the amount of land being removed from the Agricultural Land Reserve or other concerns about the route. The first letter to Terra Energy (Exhibit B, Affidavit of Tim Beatty, April 14, 2010) indicated, "I am prepared to allow entry onto my ranch, subject to a complete agreement in writing and payment of the first year entry fees and annual rentals". The letter goes on to set out the "conditions for entry". The conditions include:

- All access construction, well site construction and, after well site completion, the construction of high grade roads complete with culverts to access the adjoining fields to be done by Rhyason Contracting Ltd.
- Construction of facilities and future operations to be done by Rhyason Contracting Ltd.
- Road access security during construction to be performed by Rhyason Contracting Ltd. at $1500/day
- A minimum annual fee of $20,000 for monitoring and managing security on the ranch lands after the construction period
- Initial right of entry for each wellsite to be $20,000
- Annual rentals for each drilled well to be at a minimum of $1,000 per acre. Future rental reviews will be subject to a minimum 3% annual increase compounded over the first five year rental period
- Signing bonus of $20,000
- Any death or injury to livestock will be reimbursed at a fee of minimum $2,000 per animal
- Annual weed control and monitoring by landlord to be at an annual fee of $3,000. In the event of introduction of any weed not present on the ranch lands, the cost of control will be increased by an annual amount of $5,000, for each introduced identifiable or prominently observable weed
- Road use agreement will provide the landlord with a $600/acre annual rental subject to the five year annual review increase at 3% compounded annually

[25] These conditions primarily relate to compensation and ensuring that Mr. Rhyason's contracting company would be engaged to do all of the associated construction work. Even with respect to conditions related to environmental concerns, such as weed control, the condition includes the annual fee to be paid to Rhyason Ranch as landlord for annual weed control and monitoring, and the increased fees payable for the introduction of new weeds.

[26] In its response to the proposed conditions, Terra Energy noted that it should not award contracting work outside a fair bidding process. Mr. Rhyason's letter of August 1, 2006 to Terra Energy again expressed consent to Terra Energy's entry onto the Rhyason Ranch Lands subject to various revised conditions including:

- Access construction and future maintenance to be undertaken by Rhyason Contracting Ltd. on a competitive basis
- Road use agreement will provide the landowner with a $800 per acre annual rental, subject to the five year annual review increase of 3% compounded annually
- Wellsite construction to be undertaken by Rhyason Contracting Ltd. on a competitive basis
- Right of entry for each well is to be $25,000.00
- Annual rental is to be $1,000.00 per acre or a minimum of $5,000.00 per wellsite, whichever is greater
- Future rental increases to be based on a 3% annual increase compounded annually
- Facilities and pipelines to be undertaken by Rhyason Contracting Ltd. on a competitive basis
- Payment of an outstanding account and collection expenses for an earlier work invoice

[27] Most of the conditions again relate solely to compensation or ensuring that Rhyason Contracting Ltd. will do the construction work. Some of the amounts set out for compensation increase from the earlier letter. The only condition mentioned under the heading of environmental issues is the matter of weed control, again with fees payable to Rhyason Ranch as the landlord. The only route issue expressed is that access be diverted around the ranch yard site (paragraph 1 (f)). Terra Energy's response of August 21, 2006, indicated construction activities would be competitively bid to 2-4 contractors including Rhyason Contracting Ltd. Without proposing specific amounts for compensation, Terra Energy indicated it would pay "market rates for access determined using area precedents and legislated requirements". Terra Energy agreed to divert access roads around the ranch yard site.

[28] It was not until after Terra Energy filed its Statement of Points and newly engaged counsel for Rhyason Ranch sought to adjourn the arbitration that "environmental concerns" with the proposed route for the access road were raised as an issue.

[29] I find Mr. Rhyason's position at the arbitration that the proposed route was not appropriate, and that an alternate route should be used, to be entirely inconsistent with the position taken by him throughout the proceedings up until that time. Until then, the conditions of entry essentially related to the amount of compensation payable and the contracting of the construction work. Mr. Rhyason was content to have Terra Energy access the Rhyason Ranch Lands as long as he received the compensation demanded and on the condition that his company would benefit by being contracted to do the work. It was not until just

prior to the scheduled arbitration that he took the position that the route for the access road was not appropriate. Mr. Rhyason invited the entry hoping to be able to benefit financially from it. When Terra Energy was not agreeable to the financial conditions, he was no longer prepared to consent to the entry and took the position that Terra Energy should consider an alternate route.

[30] I do not accept Rhyason Ranch's contention that it was unreasonable in the circumstances for Terra Energy to refuse to consider an alternate route. The arbitration had already been delayed to accommodate Mr. Rhyason. The proposal for an alternate route came too late in the day and was entirely inconsistent with the negotiations to date. I agree with the arbitrator's characterization that the positions taken by Mr. Rhyason with respect to compensation were "unrealistic". While it is unfortunate the parties did not step back and reassess the situation when Mr. Rhyason suggested an alternate route, given the tenor of the negotiations to that point, the fact that the route had prior to that point been acceptable to Mr. Rhyason and, in fact, had been proposed in consultation with him, the subsequently unrealistic positions taken by Rhyason Ranch with respect to compensation, and the necessity to proceed through the Board before applying to the OGC, it is understandable that Terra Energy would want to proceed with the arbitration.

[31] Mr. Rhyason's position at the arbitration that the proposed route for the access road through the Rhyason Ranch Lands was inappropriate, and that there was a better route to access the proposed wellsites using public roads was ultimately accepted by the OGC. The right of entry granted by the Board was never exercised. But given that the concerns raised with the route were not raised until late in the day and that they were concerns that were outside of the jurisdiction of the Board in any event, I fail to see how the fact that the OGC denied Terra Energy's application for the proposed access road should now make Terra Energy responsible for a greater proportion of Rhyason Ranch's costs of the arbitration.

[32] I agree that it would have been preferable if Terra Energy's application to the OGC could have been dealt with prior to the Board being asked to issue an entry order and determine compensation for the proposed entry. At the time, however, the administrative policies in place required the applications to proceed in the order that they did. It is not Terra Energy's fault that it felt compelled to proceed to the Board before making an application to the OGC. The less than optimal dispute resolution model in place resulted in all parties, including the Board, expending resources that need not have been expended. The Board and the OGC have since entered a Memorandum of Understanding to avoid situations where the Board is asked to issue an entry order before all of the regulatory issues within the jurisdiction of the OGC respecting a proposed installation are worked out. If there are regulatory issues with a proposed oil and gas installation, the Board will now defer its processes pending resolution of

those issues by the OGC. In that way, landowners, companies and the Board will not expend resources and incur costs in Board proceedings respecting right of entry in the absence of the regulatory concerns having already been addressed.

[33] While there has been a change of circumstances since the Board rendered its Costs Decision, I am not satisfied that I should exercise the Board's discretion to vary the costs award in view of all of the circumstances. It is likely that had matters played out differently, including if the regulatory concerns with the route had been identified earlier on and if the OGC's processes had preceded the Board's processes, that Rhyason Ranch may have incurred considerably less costs in relation to the Board's processes than it ultimately did. But I am not convinced, in all of the circumstances, that Terra Energy should be responsible for bearing all or a greater portion of Rhyason Ranch's costs of the arbitration, or that the arbitrator's award of costs should be varied.

## CONCLUSION

[34] I decline to vary the Costs decision and dismiss the application.

Dated May 12, 2010

FOR THE BOARD

Cheryl Vickers
Chair