RECENT JUDICIAL DEVELOPMENTS OF INTEREST TO OIL AND GAS LAWYERS

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In this article, the authors identify and discuss recent cases that impact on the oil and gas industry. These cases cover different areas of law including constitutional law, lands, leases, and titles, industry agreement, and fiduciary obligations.

Les auteurs identifient et examinent plusieurs arrêts récents déterminants pour le secteur pétrolier et gazier. Ces causes couvrent divers secteurs de droit — droit constitutionnel, biens-fonds, baux et titres, accord relatif à l'industrie et obligations fiduciaires.

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believe that this is the only means by which IOGC can question the netback methodology adopted by a lessee to determine a wellhead value. The authors reject that proposition. Implicitly, the proposition must also have been rejected by the courts in both the *Shell* and *Stoney* cases. Both cases proceed on the assumption that the manager has the residual authority to deny a lessee the opportunity to deduct certain costs from its sale price.

Determining market price. — Market price was not raised directly in any of these cases, and IOGC made no attempt to use its deeming power under the regulations. There are hints of larger questions here. For example, DeSorcy alludes to the fact that Imperial did not necessarily accept that Imperial's posted field price was a market price. The issue was not pursued. That issue, the use of the "posted price" system for the purposes of royalty calculations, is currently front and centre with federal oil and gas leases in the United States. The United States Department of the Interior has joined litigation that questions whether the lessees' posted prices are in fact fair market value.[158] Unless IOGC adopts its own procedures for deeming price based on, for example, AEC-hub prices, IOGC may need to determine whether posted prices, reference prices and other such non-arm's length valuations do in fact produce fair market values.[159]

The fiduciary duty of the Crown. — Rothstein J. played down the significance of the Crown's fiduciary duty to First Nations in developing his interpretive approach to the regulations. Gibson J. took a very different view in the *Shell* case, and the court of appeal found it unnecessary to comment. The issue arose in a very different context in the *Stoney* case since the plaintiffs sought to argue that PanCanadian was a trustee for the Stoneys rather than a more limited interpretive argument. It is to be hoped that the Federal Court of Appeal will offer more guidance on this issue when it hears the appeal in *Imperial*.

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158 *Johnson* v. *Shell*, U.S. District Court (Eastern District Texas-Lufkin Division) Action # 9.96 cv 66.

159 See generally, Rocky Mountain Mineral Law Institute on Federal Indian Oil and Gas Royalty Valuation and Management II, February 1998 and especially, Dillon, "Independents — Large to Small — Say Yes to RIK" and Hagemeyer, "Royalty-in-Kind" [unpublished].

I. CONSTITUTIONAL LAW

Determining which level of government has legislative authority over "works"[1] and "undertakings"[2] is not always easy. The cases often seem conflicting. Why, for example, is a quarry dedicated solely to an interprovincial railway not a federal undertaking,[3] whereas underground storage caverns utilized exclusively to store gas for the benefit of shippers along an interprovincial pipeline are federal undertakings?[4] How is it that one local railway connected to an interprovincial railway is a federal undertaking, and another is not?[5] In its latest decision on this topic, the Supreme Court of Canada in *Westcoast Energy* v. *Canada (National Energy Board)*[6] has attempted to rationalize this seemingly inconsistent case law. Whether or not the Court was successful is open to debate; however, the case arguably strengthens, if not expands, federal legislative authority over some types of integrated but recognizably distinct and divisible works and undertakings.

A. *WESTCOAST ENERGY* V. *CANADA (NATIONAL ENERGY BOARD)*[7]

Westcoast Energy Inc. ("Westcoast") made application to the National Energy Board (the "NEB") for certain exemption orders and certificates in respect of two proposed expansions of its gathering pipeline and processing plant facilities in the Fort St. John and Grizzly Valley areas. The Grizzly Valley application was adjourned, and the NEB determined that it did not have jurisdiction in relation to the Fort St. John application as the proposed facilities were not "federal works or undertakings" within the meaning

1 This word was defined in *City of Montreal* v. *Montreal Street Railway*, [1912] A.C. 333 (P.C.) at 342 as "physical things, not services," and this definition was adopted by the Supreme Court of Canada in *Westcoast Energy* v. *Canada (National Energy Board)*, *infra* note 6 at para. 47.

2 In *Westcoast Energy* v. *Canada (National Energy Board)*, *infra* note 6 at para. 47, the Supreme Court of Canada adopted the definition of "undertaking" utilized by the court in *Re Regulation & Control of Radio Communication*, [1932] 2 D.L.R. 81 (P.C.) at 86. That court defined "undertaking" as "not a physical thing but ... an arrangement under which ... physical things are used." The Supreme Court also cited Professor Hogg in P.H. Hogg, *Constitutional Law of Canada*, looseleaf, vol. 1 (Scarborough, Ont.: Carswell, 1997) at 22-2 to 22-3 and the *dicta* of Dickson C.J. in *Alberta Government Telephones* v. *Canada (Canadian Radio-Television and Telecommunications Commission)*, [1989] 2 S.C.R. 225 at 259, where he stated that "[t]he primary concern is not the physical structures or their geographical location, but rather the service which is provided by the undertaking through the use of its physical equipment."

3 In *National Railway* v. *Nor-Min Supplies*, [1977] 1 S.C.R. 322, the Supreme Court of Canada concluded that a quarry situated adjacent to the railway whose output was devoted exclusively to providing ballast for the railway did not make the quarry a part of the transportation enterprise but merely fed the convenience of the railway.

4 See *Dome Petroleum* v. *Canada (National Energy Board)* (1987), 73 N.R. 135 (F.C.A.).

5 See *Luscar Collieries* v. *McDonald*, [1927] A.C. 925 (P.C.) [hereinafter *Luscar*] and compare *United Transportation Union* v. *Central Western Railway*, [1990] 3 S.C.R. 1112 [hereinafter *U.T.U.*].

6 [1998] S.C.J. No. 27, online: QL (SCJ); [1998] 1 S.C.R. 322 [hereinafter *Westcoast Decision* cited to SCJ].

7 *Ibid.* Although the case deals with a number of issues, including the degree of curial deference the court owed to the NEB's determination and the meaning of "pipeline" under the *National Energy Board Act*, R.S.C. 1985, N-7, the discussion in this article is limited to the constitutional question.

of paragraph 92(10)(a) of the *Constitution Act, 1867*.[8] Westcoast appealed the decision to the Federal Court of Appeal which held that both proposed facilities were part of a single federal undertaking. B.C. Gas Utility Ltd. appealed to the Supreme Court of Canada, which upheld the Federal Court of Appeal's determination.

Westcoast is in the natural gas midstream business, a relatively new and growing industry in Canada compared to the United States. It provides support services to natural gas producers ranging from gathering to processing and transporting natural gas along major pipelines. Westcoast's business is described by the Supreme Court of Canada at para. 2 as follows:

> The respondent, Westcoast Energy Inc. ("Westcoast"), owns and operates an integrated natural gas pipeline system. Raw natural gas is received from production fields located in the Yukon, the Northwest Territories, Alberta and British Columbia and transported through gathering pipelines to gas processing plants where it is processed to remove impurities. The processed gas is transported through Westcoast's mainline gas transmission pipeline to delivery points within British Columbia and the United States.

The facilities proposed by Westcoast largely involved gathering and processing activities in British Columbia. The NEB viewed "processing" as an activity distinct from transportation and concluded that the facilities were not integral to Westcoast's mainline transmission pipeline. Gathering, processing, and mainline transmission tolls were calculated separately, and customers could contract for gathering and processing services separately from Westcoast's transmission services. As a result, the proposed facilities did not form part of a single federal undertaking.[9]

Both the Federal Court of Appeal and six justices of the Supreme Court of Canada[10] held that the difference in the activities was not relevant to the determination:

> Whether the Westcoast gathering pipelines, processing plants and mainline transmission pipeline constitute a single undertaking depends on the degree to which they are in fact functionally integrated and managed in common as a single enterprise. What is important is how Westcoast actually operates its business.[11]

[8] (U.K.) 30 & 31 Vict., c. 3, reprinted in R.S.C. 1985, App. II, No. 5. Section 92(10)(a) provides that in each province, the legislature may exclusively make laws in relation to "Local Works and Undertakings other than such as are of the following Classes: — (a) ... other Works and Undertakings connecting the Province with any other or others of the Provinces, or extending beyond the Limits of the Province." Although there is no separate head under s. 91 dealing with "Federal Works and Undertakings," the residual power to deal with matters not enumerated in s. 92 lies with the federal government pursuant to s. 91(29). For a discussion of the residuary nature of the federal government's power, see Hogg, *supra* note 2, c. 17.

[9] A discussion of the NEB's findings is found in the *Westcoast Decision*, *supra* note 6 at para. 23.

[10] McLachlin J. dissenting.

[11] *Supra* note 6 at para. 67.

McLachlin J. (as she then was), the lone dissenter on the Supreme Court of Canada, characterized the Federal Court of Appeal's application of the law as an "economic integration test" which did not conform to the "functional integration" test set out by Dickson C.J. in *U.T.U.*[12] Whereas the majority concluded that the nature of Westcoast's business was such that the proposed facilities constituted part of a single federal undertaking, McLachlin J. held that there was nothing "interprovincial" about the facilities; therefore, they would only fall under federal jurisdiction if they were considered to be integral to the mainline transmission pipeline. She concluded they were not.

Noting the unique nature of Westcoast's business operations (*i.e.* it did not own the resources but provided support services only), the majority relied on the fact that Westcoast's integrated pipeline was under common ownership, management, control, and direction, with each aspect of the mainline transmission business functionally integrated and operated, and necessary to facilitate the transmission of the natural gas through the mainline transmission pipeline.[13] This distinguished Westcoast's business from independently owned processing plants that fed into the Westcoast transmission pipeline. In making this distinction, the majority noted that in *Luscar*,[14] the Privy Council had found that a provincial rail line that was connected to Canadian National Railway Company's ("CN") interprovincial rail line formed part of CN's federal undertaking because it was operated by CN. In *U.T.U.*,[15] a similar case, Dickson C.J. distinguished the *Luscar* case by noting that CN did not operate the provincial rail line. Co-ordination of activities of the two rail lines was insufficient to constitute the provincial rail line as part of CN's federal undertaking.[16]

In her dissent, McLachlin J. suggested that the majority had not properly applied Dickson C.J.'s "functional integration" analysis, holding at paras. 122 and 123:

> The jurisprudence on when a local work may be brought under federal jurisdiction by virtue of its relationship to an interprovincial work or undertaking reflects the exceptional nature of s. 92(1)(a) and the narrow purpose that animates it — .... The cases disclose a concern that if the test is drawn too

12 *Ibid.* at para. 159.

13 See *ibid.* at paras. 68-77, where the majority noted that Westcoast did not own the natural gas. The raw gas that was extracted from the production fields contained impurities that had to be removed, as these impurities were corrosive to the mainline transmission pipeline. Certain impurities, such as hydrogen sulphide, are toxic and pose unacceptable safety and environmental risks. The gathering systems themselves crossed provincial boundaries and, as such, were clearly federal "works." All of the facilities and personnel were under common control or management. Most significantly, Westcoast did not offer processing services independently from its gathering and transmission services. Finally, the entire undertaking was connected by a sophisticated telecommunications system.

14 *Supra* note 5.

15 *Supra* note 5.

16 Another case that could have been cited in support of this proposition is *Canadian Pacific Railway* v. *British Columbia (A.G.)*, [1950] A.C. 122 (P.C.) where the Privy Council noted that, if a particular hotel on the railway line was owned and operated by Canadian Pacific Railway Co. ("CP") for the benefit of its passengers, the hotel operations could be construed as forming part of CP's interprovincial rail line for the purposes of s. 92(10)(a).

> broadly, a host of provincial works and undertakings may be subsumed into the federal sphere in a way that undermines the basic division of powers between the federal government and the provinces.
>
> The test which emanates from recent decisions is that of "functional integration" .... What is meant by functional integration ... is more than a "unified system which is widespread and important".... And it is "something more than physical connection and mutually beneficial commercial relationship.

According to McLachlin J., the key consideration is the dominant purpose of the work or undertaking in issue. That purpose, moreover, must relate to communication or transportation.[17] While McLachlin J. conceded that the factors reviewed by the majority were "factors for consideration" in the analysis, they should not be determinative where physical connection and operational integration are necessary features of the industry itself rather than the organization of a particular business.[18]

It is noteworthy that the majority and the dissent applied two distinct conceptual approaches to the determination of the issue. While the majority focused on the nature of the business undertaking being carried on by Westcoast and the role of the facilities in that business, the dissent focused on the nature of the facilities themselves. As a result, the case presents two inconsistent, albeit equally compelling and logical, determinations. The majority referred to Westcoast's situation as "unique." However, as the midstream natural gas business grows and evolves, as it has in the United States, the majority decision has the potential to result in a "host of provincial works and undertakings" being "subsumed into the federal sphere." Given this trend, it will be for future cases to determine whether the majority's decision should or will be interpreted with a narrower scope. For now, the majority's decision in the Westcoast Decision stands as the latest *dicta* of the Supreme Court of Canada. No doubt, as the midstream natural gas business grows, several more battles on this issue will come before the courts in order to test the scope of the decision. One such decision has already been issued by the Federal Court of Appeal, as discussed in the next section.

B. *CANADIAN HUNTER EXPLORATION* V. *CANADA (NATIONAL ENERGY BOARD)*[19]

In the Westcoast Decision, the majority was careful to point out that Westcoast's business operations were unique and distinguishable from independently owned (usually producer-owned) processing plants that feed into interprovincial pipelines. Following the Westcoast Decision, Canadian Hunter Exploration Ltd. appealed a 1996 decision of the NEB wherein the NEB determined that it had jurisdiction over certain natural gas gathering system facilities between natural gas wells and a central tie-in point (all within the province of British Columbia). Located at the central tie-in point was a facility for the extraction of water and some impurities from the natural gas. The central tie-in point was connected to a 17.2 kilometre pipeline (the "Hamburg Pipeline") that crosses the British Columbia border in order to connect with the NOVA Gas Transmission Limited pipeline transmission system. It was not in dispute that the

[17] *Supra* note 6 at para. 128.
[18] *Ibid.* at paras. 144-45.
[19] [1999] F.C.J. No. 460 (C.A.), online: QL (FCJ).

Hamburg Pipeline was a "federal work and undertaking." At issue was whether the gathering system and tie-in facilities formed part of the Hamburg Pipeline or whether they were "local works and undertakings."

Although the producers who owned the facilities also owned the Hamburg Pipeline, the Federal Court of Appeal held that the primary undertaking was the production of gas by producers. The Hamburg Pipeline was clearly secondary and incidental to that purpose.[20]

Although the Court of Appeal purported to apply the Westcoast Decision, it is interesting that it used McLachlin J.'s dissenting analysis — the dominant purpose test — to maintain this distinction and make this determination.

II. ADMINISTRATIVE LAW

A. *ST. JOHN'S (CITY OF)* V. *CANADA (CANADA-NEWFOUNDLAND OFFSHORE PETROLEUM BOARD)*[21]

In enacting oil and gas disposition legislation for public lands, the "new" oil and gas producing jurisdictions have been concerned with much more than the nature of the rights granted and the collection of economic rent. These jurisdictions have seen oil and gas exploration and production as a vehicle to be used for broadly based economic development and, without exception, they require developers to enter into socio-economic agreements or plans dealing with a range of development matters and business practices including procurement policies, employment preferences for residents, training programs, and educational support.[22]

Newfoundland is no exception; thus, when Petro-Canada ("PC") sought approval for its offshore Terra Nova project, it had to submit a benefits plan for approval. One of the conditions of the plan was that PC was required "[a]s soon as possible after Project Sanction ... [to] relocate engineering and procurement activities for the Project [from the UK] to Newfoundland." PC went ahead with the project and then sought to resile from this condition on the grounds that it would significantly increase costs and delay the project. PC proposed instead to take staff to the UK for further training. Although disappointed, the regulator, the Canada-Newfoundland Offshore Petroleum Board (the "Board"), decided to accept PC's proposal as fulfilment of the condition but did not formally waive the condition.

The City of St. John's (the "City") sought to compel the Board to enforce the condition. Orsborn J. rejected the City's application and, in the course of doing so,

20 Although not cited by the court, Hogg, *supra* note 2 at 22-13 notes that "the relationship of dependency that will bring a local undertaking into federal jurisdiction is the dependency of the interprovincial undertaking on the local undertaking, not the other way around."

21 [1998] N.J. No. 233 (S.C.(T.D.)), online: QL (NJ).

22 For a good discussion of some of the legal issues, see M. Harrington *et al.*, "Emerging Issues in East Coast Oil and Gas Development" (1997) 35 Alta. L. Rev. 269.

offered some interesting comments on the responsibilities of the Board and on the legal character of the offshore regime. The court held that the condition was expressed in mandatory terms. It was not simply a "best efforts" undertaking. In this case, the condition had not been fulfilled.[23] Nevertheless, the City could not enforce compliance for three reasons. First, the City was acting beyond its charter in attempting to enforce the condition.[24] Secondly, the City could not obtain a *mandamus* order against the Board since the relevant statute (the *Canada-Newfoundland Atlantic Accord Implementation Act*[25] (the "*Accord Act*")) did not impose a clear statutory duty[26] on the Board to enforce conditions attached to an approved benefits plan. Instead, it was clear that the *Accord Act* has "constitutional overtones."[27] It represented a "carefully constructed ... joint management regime." Issues of economic benefits were to be left to the Board, "subject only to joint direction from the governments."[28] Thirdly, since there was no duty owed to the City to enforce the clause, the City lacked standing for *mandamus* purposes. Furthermore, even if there was a duty, the court seemed to suggest that the duty might be owed to the citizens of the City and not to the City itself.

The court's comments on the capacity of the City to sue give rise primarily to issues of administrative and municipal law, rather than oil and gas law, but the court went on to comment on the quasi-constitutional nature of the offshore regime as a creature of a federal-provincial accord. That accord, implemented by federal and provincial legislation, meant that the province was "not competent ... to give to a statutory body such as a municipality the authority to seek to require enforcement of the conditions of an employment plan approved by the Board."[29] Stated as a limitation on power rather than as an interpretive principle,[30] this statement goes too far since it invests the accord and its implementing legislation with the status of a constitutional norm. It is not; it is merely a federal-provincial agreement.[31]

23 *Supra* note 21 at paras. 85, 89.
24 *Ibid.* at paras. 36-54.
25 R.S.N. 1990, c. 2.
26 *Supra* note 21 at paras. 91 *et seq.* and applying *Karavos* v. *The City of Toronto*, [1948] 3 D.L.R. 294 (Ont. C.A.) [hereinafter *Karavos*].
27 *Ibid.* at para. 95.
28 *Ibid.*
29 *Ibid.* at para. 60.
30 On the use of the accord to influence the interpretation of the mirror or reciprocal implementing legislation, see *Mobil Oil Canada* v. *Canada (Canada-Newfoundland Offshore Petroleum Board)*, [1994] 1 S.C.R. 202, 163 N.R. 27 especially at paras. 22, 30, 38, and 43-45. See also *Petro-Canada* v. *Canada (Canada-Newfoundland Offshore Petroleum Board)* (1995), 127 D.L.R. (4th) 483 especially at para. 18.
31 On federal-provincial agreements generally, see N. Bankes, "Co-operative Federalism: Third Parties and Intergovernmental Agreements in Canada and Australia" (1991) 29 Alta. L. Rev. 792.

B. *ALBERTA (ENERGY RESOURCES CONSERVATION BOARD)* v. *SARG OILS*[32]

The facts, somewhat simplified, were as follows. Sarg Oils Ltd. ("Sarg") had acquired certain Crown leases on which were located a number of non-producing or poorly producing wells. Sarg decided to sell these properties and entered into an agreement with Sundial. Title was conveyed, and Sarg also executed well licence transfers that the transferee undertook to submit to the Energy Resources Conservation Board ("ERCB") for its approval.[33] Sundial subsequently sold the lands to Petenco and 3D, who scavenged the sites and disposed of salvageable material. The Crown leases expired and the ERCB directed Sarg to abandon the wells located on the cancelled leases. Sarg was still the licensee of record since the ERCB, after sitting on the well licence transfers for a period of time, had declined to approve them. The ERCB ultimately procured an Order-in-Council which ratified an ERCB order requiring Sarg to abandon the wells.[34] Upon Sarg's failure to do so, the ERCB abandoned them itself and submitted the bill to Sarg. In doing so, the ERCB relied on s. 93 of the *OGCA* which creates a deemed statutory indebtedness where the Board carries out an operation upon the failure of a party to abandon a well in accordance with an ERCB order. The ERCB sued Sarg on the statutory debt and failed at trial before Lutz J.

Much of Lutz J.'s judgment is concerned with the question of collateral attack.[35] Should Sarg be able to question the validity of the abandonment orders in a civil debt action when Sarg had failed to pursue its full range of internal and judicial remedies, including an application for a hearing and the statutory appeal provided under the *Energy Resources Conservation Act*?[36] The authors' view is that Lutz J. misapplies the *Maybrun* decision of the Supreme Court of Canada[37] and that, as a result, the decision is open to attack. Here the authors propose to concentrate on the grounds on which Lutz J. denied relief to the ERCB, assuming that he was correct and that this was a case in which he should have exercised his discretion to consider the merits of Sarg's objections to its indebtedness.

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32 [1998] A.J. 1039 (Q.B.), online: QL (AJ) [hereinafter *Sarg*]. The case is on appeal. For collateral proceedings dealing with Sarg's obligations under the *Environmental Protection and Enhancement Act*, S.A. 1992, c. E-13.3, see *Sarg Oils* v. *Alberta (Environmental Appeal Board)* (1996), 185 A.R. 118, 36 Admin. L.R. (2d) 134 (Q.B.). This case involved a successful judicial review application to quash a "decision" of the Environmental Appeal Board ("EAB") confirming an environmental protection order for the reclamation of certain well sites. The EAB's rehearing of that matter, *Sarg Oils* v. *Alberta (Department of Environmental Protection)* is available at [1996] A.E.A.B.D. 15, online: QL (AEABD).

33 See s. 18 of the *Oil and Gas Conservation Act*, R.S.A. 1980, c. O-5 [hereinafter *OGCA*] prior to amendment by S.A. 1994, c. 26.

34 See ss. 7 and 8 of the *OGCA*. The Board's power to order abandonment is clarified by S.A. 1994, c. 26, which added s. 20.2.

35 *Sarg*, *supra* note 32 at paras. 111-46.

36 R.S.A. 1980, c. E-11, ss. 42, 43, 44 [hereinafter *ERCA*].

37 See *R.* v. *Consolidated Maybrun Mines* (1998), 158 D.L.R. (4th) 193 (S.C.C.) [hereinafter *Maybrun*] and *R.* v. *Al Klippert Ltd.* (1998), 158 D.L.R. (4th) 219 (S.C.C.). The authors' main reason for this conclusion is that Lutz J. reached his decision without seriously considering the implications of the finality and privative clauses in both the *ERCA* and the *OGCA*.

Lutz J. offers two separate grounds for denying recovery. The grounds are doctrinally distinct but conceptually linked. The first ground is the jurisdictional principle of administrative law and the linked ideas of procedural fairness and legitimate expectations. The second ground, estoppel, is more commonly associated with private actions.

Lutz J. held that the ERCB committed certain procedural errors in its treatment of the application to transfer the well licence to Sundial. These errors constituted breaches of both the common law rules of procedural fairness and the ERCB's statutory obligations under s. 29 of the *ERCA* and under ss. 3 and 4 of the *Administrative Procedures Act*.[38] The ERCB's procedural errors lay in its failure to provide Sarg with notice of the adverse decision that it was about to make. As a result, Sarg was deprived of the opportunity to make submissions with respect to that decision. These omissions were particularly critical because there was evidence to the effect that the ERCB was going through a change in its policies for the treatment of well licence transfer applications which it had not yet communicated to the industry.[39] Absent communication as to this change of policy in the usual form of an ERCB Information Letter or Interim Directive, Sarg was entitled to assume (or had a reasonable or legitimate expectation[40]) that its transfer application would be approved by the ERCB in the ordinary course of its business.

But allowing for the accuracy of this analysis, how should this prevent the ERCB from suing on the statutory debt? What is the connection between the licence transfer matter and the statutory indebtedness? On this crucial point Lutz J. relies on assertion and rhetoric rather than reasoning:

> The procedure followed by the ERCB involved unnecessary delay, it involved hidden policies and it involved adverse decisions being made unbeknownst to the affected party. In a word the procedure was unfair. It was unfair according to the statutory standard of procedural fairness and according to the common law construction of procedural fairness. Consequently, the ERCB should not be permitted to enforce the statutory debt that arose as a result of the unfair procedures. The ERCB's claim must therefore be dismissed.[41]

What is missing here is some reasoning directed at establishing that Sarg is no longer the licensee of record and therefore cannot be compelled to abandon the well. The real problem for Sarg is that the usual result of a jurisdictional error (voidness of the decision) does not put Sarg in the position it wants to be in. After all, Sarg wants to be rid of the licence. It needs a remedy that will divest it of the continuing responsibilities of a licensee. There may be several routes to this conclusion. One route is undoubtedly estoppel (dealt with below).

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38 R.S.A. 1980, c. A-2 [hereinafter *APA*].

39 *Sarg*, *supra* note 32 at para. 157.

40 *Ibid.* at para. 169.

41 *Ibid.* at para. 175.

A second route might be based upon the presumed availability of *mandamus*. The argument must be that the ERCB can be compelled to approve a transfer application provided that the application is in proper form and meets all the requirements that the ERCB has historically imposed on applicants. This way of putting the case draws most directly on Strayer J.'s decision in *Aurchem Exploration* v. *Whitehorse Mining Recorder*,[42] cited and relied upon by Lutz J. in the context of his estoppel discussion. The analogy is not precise, however, because Sarg is raising the issue collaterally. It is also noteworthy that, while Strayer J. granted the *certiorari* application in *Aurchem*, he declined to grant *mandamus*.[43] The collateral nature of the attack also tends to divert attention away from the elements of *mandamus* that Sarg would have had to establish had it been the plaintiff. The usual statement of the elements that a plaintiff must prove for *mandamus* is that of the Ontario Court of Appeal in *Karavos*.[44] In summary, an applicant must show: (1) that it has a clear legal right, (2) that the duty was actually owed at the time of the application, (3) that the duty is purely ministerial in nature; and (4) that there was a demand and a refusal. It is not clear that Sarg could meet these tests; however, the court did not consider the question, as it effectively granted *mandamus* by the backdoor.[45]

A third route is perhaps based on the fact that a procedural error will render void not only the particular decision (not really the issue here because, as noted above, Sarg needed more) but all subsequent steps in the chain. This alternative way of making the argument is not without its difficulties. What are the elements of the chain? What subsequent decisions are so linked to the earlier decision that they are tainted by it? Can an earlier error ever be cured in the manner that a decision-maker is usually able

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42 (1992), 7 Admin. L.R. (2d) 168 (F.C.T.D.) [hereinafter *Aurchem*]. The plaintiff was endeavouring to acquire open ground between existing recorded claims. Following standard practice in Yukon at the time and in order to avoid inadvertently leaving open ground, it located its two post claims on land that was already staked and made an application to record claims of standard size, rather than staking and recording fractional claims. The mining recorder, following an inspection on the ground but without giving the applicant an opportunity to make submissions, rejected the application. Strayer J. granted *certiorari* at para. 12:

> I do not believe that the procedure followed meets the common law requirements of fairness. Substantial interests of the applicants for the recording of claims are at stake in such a process. There is no ready means for seeking review of the refusal to record once that decision is taken. Therefore it was incumbent upon the ... Recorder here to give the applicant Aurchem or its representative an opportunity to know what concerns were raised by the inspection report and to respond to those concerns if possible.

43 *Ibid.* at para. 14.

44 *Supra* note 26.

45 Perhaps another way to think of the case is that Sarg has actually recovered damages for the negligent exercise of a statutory authority, again by the back door. If Sarg would have faced difficulties in succeeding on a *mandamus* application, it would have faced at least as difficult a task making a counterclaim based upon either negligence or misfeasance. See *e.g.*: *Rowling* v. *Takaro Properties*, [1988] A.C. 473 (P.C.); *Wellbridge Holdings* v. *The Metropolitan Corporation of Greater Winnipeg*, [1971] S.C.R. 957; *Dunlop* v. *Woollhara Municipal Council*, [1982] A.C. 159 (P.C.); *X (Minors)* v. *Bedfordshire CC*, [1995] A.C. 633 (H.L.); *Comeau's Sea Foods* v. *Canada (Minister of Fisheries and Oceans)*, [1997] 1 S.C.R. 12 and see especially the judgment in that case in the court of appeal at 123 D.L.R. (4th) 180 (F.C.A.); and *Dorman Timber* v. *British Columbia* (1997), 152 D.L.R. (4th) 271 (B.C.C.A.).

to cure procedural errors? Does it matter that Sarg did not launch a direct attack on any of the subsequent decisions in the chain?

Lutz J. does not deal with any of these difficulties. He simply contents himself with the flat statement that the ERCB cannot recover because of the unfair procedure. In the authors' view, this is too simplistic an analysis, especially when combined with Sarg's reliance on a collateral attack rather than a direct attack. At one level, there is an obvious nexus between the transfer application and the subsequent indebtedness (certainly at the "but for" level of causation), but, as a policy matter, this way of analyzing the problem makes it much too easy for Sarg to escape its liability.

Lutz J. dealt with the estoppel argument as an alternative.[46] Thus the two grounds are kept distinct but at the same time there is a clear connection between procedural fairness arguments based upon legitimate expectations and arguments based on estoppel.[47] The analysis is interesting, but once again there is something missing between the presentation of the argument and the conclusions that Lutz J. seeks to draw. By omitting some of the links in the chain of reasoning, Lutz J. is able to avoid some of the key difficulties with the estoppel analysis.

The gap in the analysis is revealed in the following quotations from Lutz J.'s judgment, in which he summarizes Sarg's argument as well as stating his own conclusions.

> [C]ounsel for Sarg argues that the ERCB should be estopped from applying the more stringent criteria to the Sarg to Sundial transfer application.
>
> Finally, counsel for Sarg argues that if the claim for estoppel is successful, the statutory debt ought not to be enforced because it was a direct result of the failure of the licence transfers to get approval because of the stricter criteria applied to the application.[48]
>
> In the absence of notification to the contrary, Sarg should be entitled to rely on the long-standing conduct of the ERCB. This is not an instance where the law of the land is being overruled — only the application of the law by the Board is being overruled.[49]

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46 This is made clear in *Sarg, supra* note 32 at para. 176. Note that in *Imperial Oil Resources* v. *Canada (Minister of Indian Affairs and Northern Development)*, [1997] F.C.J. No. 1767 at para. 38 (T.D.), online: QL (FCJ), discussed in N. Bankes and D. Rae, "Recent Cases on the Calculation of Royalties on First Nations' Land", (2000) 38 Alta. L. Rev. 258, there were arguments as to estoppel and acquiescence put forth that the court found it unnecessary to deal with.

47 See for example *Sarg, supra* note 32 at para. 178. These links can also be seen in Lutz J.'s treatment of the elements of the two different grounds of attack. For example, while discussing the procedural fairness issue at paras. 156 *et seq.*, Lutz J. was at pains to establish the nature of the damage suffered by Sarg. He did this to establish the nature of Sarg's interest in the matter and the seriousness of the issue for Sarg. These facts equally establish detriment for the purposes of the estoppel.

48 *Ibid.* at paras. 178-79.

49 *Ibid.* at para. 189.

But what precisely was the substance of the estoppel?[50] In the authors' view, the estoppel claim needs to go so far as the claim that the ERCB is estopped from denying that the licence transfer application had been approved. How else can estoppel help Sarg avoid liability?[51] If the estoppel is put on those grounds, it brings into focus the real difficulty with estoppel arguments in a statutory context. This difficulty is usually stated in the form that "estoppel cannot override the law of the land."[52]

Lutz J. had already acknowledged that the ERCB has a broad discretion with respect to licence transfer applications,[53] but he does not draw attention to the prescriptive language of s. 18 of the *OGCA* to the effect that "[a] license shall not be transferred without the consent in writing of the Board."[54] By failing to be precise both as to the substance and the effect of the estoppel, Lutz J. made it easier to reach the conclusion that his decision had not overridden the law of the land. However, if the estoppel argument is to have any meaning, the effect of the judgment must be that the licence had been transferred, notwithstanding the fact that the ERCB never consented to the transfer.

Not only does Lutz J. avoid dealing directly with the effect of the estoppel, but he also fails to discuss the elements of estoppel. Traditionally, not only must there be a representation, but there must also be reliance.[55] In a private law context this will be a question of fact; in a public law context there may also be a question of public policy. In the present context that might be put in the following terms: should Sarg be able to rely on the ERCB's past practice? Should it not have dealt with the issue of licence transfers more cautiously in its private law dealings with Sundial, its purchaser? Should it be made easy to transfer the risk to the regulator? In the authors' view, to pose this question is to answer it on the specific facts of this case. There was evidence as to conveyancing practice. Sarg seems to have acted appropriately. Drafting cannot anticipate all possibilities and all possible changes in policy. Had the ERCB communicated its change of policy, one could reasonably expect the drafting to evolve to cope with the new procedures. Thus the point here is that there were relevant questions that Lutz J. should have asked. He failed to do so, but on this specific point that is not of great moment.

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50 As to the importance of being precise as to scope of the estoppel claim, see *Voyager Petroleums* v. *Vanguard Petroleums*, [1983] 5 W.W.R. 622 (Alta. C.A.), aff'g [1982] 2 W.W.R. 36 (Alta. Q.B.), where the court held that the lessor was estopped from denying that it had executed a unitization agreement in its dual capacities as both the lessor and as a majority points holder under a royalty trust agreement.

51 Equally effective might be an estoppel aimed at estopping the ERCB from denying that the abandonment order was actually directed at the transferee, Sundial. There is only one problem with that claim in this case: it does not fit the facts at all!

52 *St. Ann's Fishing Club* v. *R.*, [1950] S.C.R. 211; *Joliffe* v. *R.*, [1986] 1 F.C. 511 (T.D.) at 524, a judgment of Strayer J. who also authored the judgment in *Aurchem*, *supra* note 42.

53 *Sarg*, *supra* note 32 at para. 153. This in itself is surely an admission that Lutz J. would not have granted *mandamus*.

54 *OGCA*, *supra* note 33.

55 There is some limited discussion of this element in *Sarg*, *supra* note 32 at para. 184.

Are there any practical differences between the estoppel analysis and the administrative law analysis?

The *OGCA* has been amended since the facts arose upon which this litigation was based.[56] Specifically, the following points should be noted. First, the basic licensing section (s. 18) has been amended to confirm and amplify the ERCB's discretionary powers to approve or refuse to approve licence transfers (s. 18(1.1)). The section has also been amended to state that no transfer is effective until approved (s. 18(6)). This may make it more difficult for a party to claim to take advantage of the estoppel argument for it will force a court to confront more directly the question of whether it is flying in the face of an express statement of legislative intent. Secondly, the amendments have added a new group of sections (ss. 20.1 to 20.4) which expressly deal with abandonment and create statutory liability for a number of persons. While the precise relationship between these new sections and the older remedies of the ERCB found in ss. 92 to 95 of the *OGCA* is not completely clear, the ERCB should be able to avoid the need for the special order in council that seems to have been required to authorize the ERCB's action in the instant case. Thirdly, the ERCB has acquired a new range of remedies to assist it in recovering the costs of an ERCB abandonment (s. 93.1).

That said, the decision is still of considerable interest. It confirms the application of both common law and statutory rules of procedural fairness to ERCB decisions and confirms the entitlement of persons affected to advance notice of decisions that may affect their ultimate liability. Failure to adhere to these requirements may cost more than delay; it may force the ERCB to absorb the costs of expensive abandonment operations. More generally, the decision also emphasizes the duty of a regulator to communicate accurately with its regulated industry. At its most general, the case stands for the following proposition: Where a regulator has an important discretionary power and where the regulator has communicated to its industry the manner in which it will exercise that power, the industry will be entitled to assume (on the basis of estoppel, legitimate expectation, or procedural fairness) that the regulator will continue to exercise that power in the manner communicated unless and until the regulator communicates its changed expectations to the industry.

C. *KELLY LAKE CREE NATION* v. *BRITISH COLUMBIA (MINISTRY OF ENERGY AND MINES)*:[57] *THE MOUNT MONTEITH DECISION*

In *Mount Monteith*, two First Nations, the Kelly Lake Cree First Nation ("KLCFN") and the Salteau First Nation ("SFN"), sought judicial review of a well authorization issued by the Ministry of Energy and Mines ("MEM") as well as cutting permits issued by the Ministry of Forests ("MOF"). The cutting permits authorized the felling of timber necessary for the well site and access road. The area in question (known as Mount Monteith) was immediately adjacent to the Twin Sisters. The area was described by the trial judge as being one of "undeveloped splendour." The Twin Sisters area was

56 S.A. 1994, c. 26.

57 [1998] B.C.J. No. 2471 (S.C.), online: QL (BCJ), [hereinafter *Mount Monteith*].

regarded by both applicant First Nations (as well as a First Nation intervening in support of the authorizations, the West Moberly First Nation ("WMFN")[58]) as an area of significant spiritual importance. The applicant First Nations argued that the Crown had breached its administrative and constitutional law obligations to consult with them prior to granting the authorizations. The Crown defended on the basis that it had fulfilled its obligations and, in the case of one of the First Nations (KLCFN), denied that it owed a constitutional obligation to consult.

Amoco and its predecessors had a long-standing interest in this area, and the MEM and its predecessor had also developed an appreciation of the importance of the area to the First Nations. The evidence presented showed that extensive studies had been carried out over a number of years. Some of these studies were developed co-operatively with the Treaty 8 Tribal Association. It seems that the application and indeed the entire area was treated as an exceptional case, and that the extent and quality of consultation was commensurate with the significance of the area to the First Nations. As a result of the studies and consultations, part of the area was set aside from development.

Amoco already held Crown oil and gas rights. It was seeking approval to drill a well under a different part of the *Petroleum and Natural Gas Act*.[59] The case for the First Nations seems to have been put on the basis that the application involved a dispute between parties that required a high degree of procedural protection in the form of a full oral hearing. Taylor J. rejected that contention:

> The decision here is not one made by a tribunal that decides upon evidence tendered before it, but rather by a statutory authority charged with the responsibility of issuing permits for forms of economic activity pursuant to the provisions of [the *PNGA* and the *Forest Act*, R.S.B.C. 1996, c. 157].[60]

The First Nations were not "parties;" they were "interested persons." There were no litigants, and no hearing was required.[61] The process required procedural fairness, but this could be discharged in the present circumstances by offering the First Nations an opportunity to make representations either in person or in writing. That opportunity had been accorded to all the First Nations affected, and thus that duty had been discharged.[62] The fact that some efforts at consultation were thwarted by the refusal of a First Nation to participate could not taint the process.[63] At a purely administrative law level this decision is correct. However, Taylor J. went on to support his decision by noting that the interest of the First Nations was not that significant anyway since their primary interest was in the spiritual significance of the area and not the

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58 In addition, another First Nation, the Halfway River First Nation, had an interest in the area but seems to have taken the same position in the matter as the WMFN.
59 R.S.B.C. 1996, c. 361 [hereinafter *PNGA*].
60 *Supra* note 57 at paras. 168, 239.
61 *Ibid.* at para. 170.
62 *Ibid.* at paras. 170-76.
63 *Ibid.* at para. 243.

importance of the area for ensuring livelihood.[64] This is a questionable jump in the reasoning; it is openly Eurocentric and ignores both the First Nation perspective as well as the strictures of the Supreme Court of Canada in *R.* v. *Delgamuukw*[65] to the effect that doctrinal rules may need to be modified to take adequate account of the aboriginal perspective.[66]

The duty was discharged notwithstanding the fact that the consultations were conducted by someone other than the final decision-maker, and notwithstanding the fact that the First Nations had no opportunity to make submissions directly:

> The duty to consult ... is not that of any individual but rather the state in its dealings with aboriginal people. I know of no authority that requires the decision-maker to personally inquire and receive the information upon which the decision is made or to personally engage in consultation. That is not a requirement of law ... and would be a physical impossibility.[67]

This comment applied not only to the well authorization decision but also to the cutting permit decision. In fact, the official responsible for the cutting permits had not conducted any independent consultations but had simply relied upon the consultations conducted by the MEM.[68] There was no duty on the MOF to duplicate the process. The First Nations' concerns were the same with respect to both aspects of the process. The MOF could not blindly follow the MEM's decision[69] (and Taylor J. held that it had not done so[70]) but could use the information collected by the MEM in making their own decision.

In addition to alleging breach of the "hearing" aspect of the rules of procedural fairness, both applicant First Nations alleged bias. The generalized allegation of bias from the KLCFN was dismissed out of hand by Taylor J.[71] The SFN argument was more sophisticated although in the end equally unsuccessful. The SFN pointed to a number of features of the decision-making that it alleged amounted to bias. First, the SFN noted that while in the ordinary course the decision would have been made by a person in the region, in the end, the decision was made by German in the Victoria office of the defendant. The SFN was not provided with notice of this change of plan

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64 *Ibid.* at para. 174. Taylor J. attempted to distinguish Dorgan J.'s decision in *Halfway River First Nation* v. *British Columbia (Ministry of Forests)*, [1997] 4 C.N.L.R. 45 (B.C.S.C.) [hereinafter *Halfway River*].

65 (1997), 153 D.L.R. (4th) 193 (S.C.C.) at paras. 84 *et seq.*

66 It is possible to support the decision in any event on the basis that, even if the First Nation interest were acknowledged as being more important, it would still not entitle the First Nation to a formal oral hearing where the Crown had already carried out extensive and intensive consultations. These consultations would likely be better suited to gaining an appreciation of the First Nation perspective than would an adversarial hearing.

67 *Mount Monteith*, *supra* note 57 at para. 241.

68 *Ibid.* at paras. 129-33.

69 Compare *Koopman* v. *Ostergaard* (1995), 12 B.C.L.R. (3d) 154 (S.C.) and *Chetwynd Environmental Society* v. *British Columbia (Ministry of Forests)* (1995), 13 B.C.L.R. (3d) 338 (S.C.).

70 *Supra* note 57 at paras. 128-33.

71 *Ibid.* at para. 177.

and hinted that the decision was pulled from the region because of concerns that the application for an authorization might be rejected at that level. Secondly, the SFN argued that, in his decision, German subordinated the interests of the SFN to those of the WMFN. He ignored the spiritual significance of the area to the SFN, refused to provide specific information to the SFN, and was more concerned with loss of industry confidence. In short, German had prejudged the application, was determined to grant it, and would not wait for further studies and consultations with the SFN. For Taylor J., all of this was either factually incorrect or did not give rise to a reasonable apprehension of bias. Only some of Taylor J.'s more important conclusions are discussed below.

First, Taylor J. noted that the *PNGA* accorded the authority to make the decision to the director (who was German, before he was appointed acting assistant deputy minister) or to a person appointed by him. There was no direct evidence to support the conclusion that the decision was pulled from the region to avoid a negative result and such a conclusion could not be inferred from the facts. Secondly, there was no requirement that the actual decision-maker (German) carry out the consultation personally. This responsibility could be discharged through other members of the civil service.[72] Thirdly, where the decision-maker makes its decision, notwithstanding evidence that one party wants to continue negotiations or consultations or to await the results of further studies, that does not itself constitute pre-determination of the matter, at least where there is an adequate information base for the decision and the desire to continue studies seems to be motivated more by a desire to delay than by a desire to find common ground.[73]

Taylor J. also dismissed various arguments based upon fettering of discretion, errors of fact the taking account of irrelevant considerations, and the failure to take account of relevant considerations. The First Nations had argued that German's decision showed that he was concerned about the effect that the long delay in dealing with this application would have on industry perceptions of the province and as to its ability to resolve First Nation issues. The court held that there was no fettering; in fact, the decision-makers had exhibited considerable flexibility by postponing the decision on a number of occasions. However, the time had come for a decision.[74] This was not a case in which German had simply applied, in rote manner, a provincial policy of not

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72 *Ibid.* at para. 122 and at para. 203:

> [T]here is no requirement that the decision-maker be the one who consults personally. Such a requirement, given the complexity of issues and interested parties such as here, would be a practical impossibility.

and at para. 207:

> There is no requirement at law for a decision-maker to personally involve him or herself in the process of consultation for it is a duty of the state to consult with those who may be affected. This as a matter of practical and common sense is done through the civil service.

and at para. 232.

73 *Ibid.* at paras. 220-22. Contrast the finding here with one of the conclusions in *Halfway River*, *supra* note 64. In that case, Dorgan J. found evidence of pre-determination when permits were issued without awaiting the outcome of agreed studies. The cases are distinguishable on the facts.

74 *Mount Monteith*, *ibid.* at para. 184.

halting resource developments in the face of treaty land entitlement claims.[75] Equally, concerns as to irrelevant considerations were unfounded. First, these considerations were actually relevant when looked at in terms of the overall history of this matter[76] and when taking account of the various studies that had been conducted. It was time for the decision to be made. Secondly, and if wrong on the first point, taking account of an irrelevant consideration would only go to jurisdiction if the decision were founded upon that consideration and if the decision could not have been made without that factor.[77] That was not the case here.

The applicants' obverse argument on relevant considerations also failed on the facts. The SFN argued that German failed to take into account the impact of the decision on the SFN's treaty rights. Taylor J. noted that while s. 93 of the *PNGA* (unlike the *Forest Act* by virtue of its incorporation of the *Forest Practices Code*[78]) did not direct German to take account of aboriginal and treaty rights, an examination of his decision established that he had in fact done so.[79] Presumably, the obverse is also true. Thus, had German decided to deny the authorization on treaty grounds, an attack on the decision by Amoco on the basis of irrelevant considerations would also have failed.

The case also raised issues of constitutional law that are not covered in this article.

D. *CHEVRON CANADA RESOURCES* V. *ALBERTA (MINISTER OF ENERGY)*[80]

Sarg suggests that regulators should not apply changes in policy retrospectively.[81] *Sarg* comes to that conclusion by an unconventional route; Marshall J.'s decision in *Chevron* is more conventional. The case deals with the pre-1994 Natural Gas Royalty Regulations ("NGRR")[82] under Alberta's *Mines and Minerals Act*.[83]

Under those regulations (which have since been replaced[84]), the royalty "client" (to borrow a term from the new regulations) could deduct certain permissible costs of processing (not exceeding 95 percent of the gross royalty payable) and was entitled to group multiple producing entities for these purposes, thereby allowing a client to reduce its royalty liability by combining entities that were less profitable with those that were more profitable. The regulations also included a general provision that allowed a client to request a recalculation for past years. In 1996, Chevron Canada Resources ("Chevron") made two grouping requests that conformed to the formal requirements of

75 *Ibid.* at paras. 235-38. On this again the case was distinguishable from Dorgan J.'s decision in *Halfway River*, *supra* note 64.

76 *Mount Monteith*, *ibid.* at 183-84.

77 *Ibid.* at 181.

78 *Ibid.* at para. 130.

79 *Ibid.* at para. 234.

80 [1998] A.J. No. 661, online: QL (AJ) [hereinafter *Chevron*].

81 See also *Shell Canada* v. *Canada (A.G.)*, [1998] F.C.J. No. 1525 (C.A.), online: QL (FCJ), aff'g [1998] 3 F.C. No. 223 (T.D.), discussed in Bankes and Rae, *supra* note 46.

82 Alta. Reg. 246/90.

83 R.S.A. 1980, c. M-15.

84 See G. Acorn & M.W. Ekelund, "An Overview of Alberta's Recent Legislation on Natural Gas Royalty Simplification and Natural Gas Storage" (1995) 33 Alta. L. Rev. 342.

the regulations. It expected to realize gains of $5.4 million plus interest if allowed. One grouping request covered the years 1992 and 1993 and the other was confined to 1992.

The applications were rejected and various reasons were communicated to Chevron. It was said that there could be no grouping between a unit and non-unit wells, and that retroactive grouping was only permissible in the case of error. Chevron was able to demonstrate many examples in which the Minister of Energy (the "Minister") had allowed grouping applications from other parties that flatly contradicted each of these reasons. In the formal decision rejecting the application, the deputy minister adduced the further reason that the grouping provision was designed for reasons of administrative convenience in reporting requirements: "it was not intended as a device that would allow royalty clients to trigger any increased financial benefits or withdrawals."[85] In sum, Chevron was using the grouping provision for an unintended purpose.[86]

Chevron sought judicial review. The NGRR did not contain a full privative clause but they did contain a finality clause:

> 30. Where any question arises pertaining to the interpretation or application of this Regulation, the Minister is the sole judge of the question and there shall be no appeal from his decision.[87]

The court decided that a high degree of curial deference (but something less strict than the patent unreasonableness test) was owed to the Minister's decision *on this particular issue*. It was a decision entirely within the Minister's jurisdiction, and while not a technical decision requiring great expertise, it was a decision that could involve policy considerations.[88]

Notwithstanding the high standard of review, Marshall J. still found that the Minister had erred. Marshall J. characterized the decision in various ways. It was incorrect or unreasonable to rule that the regulations could not be used to confer a financial benefit.[89] For the Minister to take account of the financial benefit to Chevron (or the loss to the Crown) was to take account of an irrelevant consideration or to render her decision for an improper purpose or an ulterior motive.[90] It was an incorrect or unreasonable interpretation of the regulations to insist that they could only be used to foster administrative convenience and to reject Chevron's re-calculation application on these grounds.[91] Part of the reason why this was unreasonable was that the Minister had, as a matter of practice, allowed re-calculations at the request of other clients.

This is the connection back to *Sarg*. The existence of a practice communicated to industry may prevent the Minister from changing that practice on a retrospective basis

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85 Cited in *Chevron*, *supra* note 80 at para. 10.
86 *Ibid.* at para. 10.
87 *Supra* note 81.
88 *Ibid.* at paras. 14-23, 43.
89 *Ibid.* at paras. 33, 39.
90 *Ibid.* at para. 39.
91 *Ibid.* at paras. 35, 39.

because it is unreasonable to re-interpret a discretionary power in this way. In support of this claim, consider the following. Suppose that this question had been put to the Minister as a first case: "Can a client seek a re-determination of a royalty based upon a retrospective re-grouping of facilities in order to reduce that client's royalty liability?" Clearly, the Minister would have been in a much stronger position to support her decision as a reasonable interpretation of the statute at the outset. Thus, the Minister might argue that "it is true that a client has the right to seek a re-determination of the royalty, but that need not extend to a re-consideration of grouping and I am entitled to consider the financial consequences for the Crown." While a court might disagree with this interpretation, it is hard to believe that a court would characterize the position as unreasonable. It only becomes unreasonable as a result of an interpretive practice communicated to the industry.

III. LANDS, LEASES, AND TITLE

A. *ANDERSON* V. *AMOCO*[92]

A substance may occur in different phases. For example, water may exist as a liquid, as steam, or as solid matter (ice). Phase is dynamic: a substance may change from one phase to another. Water may change into steam and condense back to water. Similarly, hydrocarbons occur in different phases as liquids, as gases or even as solids and may go through phase changes. These changes may occur during production or in the reservoir. Phase changes are induced by changes in temperature and pressure.

That the same substance may occur in different phases and change phase during the course of production gives rise to two distinct types of legal problems. The first type of problem occurs when title is split to the different phases. Who owns what? What if the substance in its different phases is intermingled? This may be thought of as a first-generation legal problem. It is exemplified by *Borys* v. *CPR.*[93] The Privy Council in *Borys* decided a number of things but did not directly deal with the second type of legal problem which relates to the dynamic aspect of phases, *i.e.* what are the ownership implications of a change in phase in the course of production? That question is the subject of the recent decision of Fruman J. in *Anderson.*[94] However, before looking at the law, a little bit more about the facts and the science should be known.

Hydrocarbon accumulations occur in three forms: oil pools, gas pools, and mixed pools. Temperature and pressure are greater in the pool than at the surface. Once production commences, pressure and temperature change. In a mixed pool or an oil pool, as pressure declines gaseous hydrocarbons emerge from liquid hydrocarbons and are known as "evolved gas" or "secondary gas cap gas." In a mixed pool, the evolved gas intermingles with and is indistinguishable from the "free gas" or "primary gas cap gas." In addition, under some conditions, changes in pressure will cause hydrocarbons dissolved in gases to condense and to be produced as liquid hydrocarbons. Some of

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92 [1999] 3 W.W.R. 255, 63 Alta. L.R. (3d) 1 (Q.B.) [hereinafter *Anderson*].

93 (1953), [1952-53] 7 W.W.R. 546 (P.C.) [hereinafter *Borys*].

94 *Supra* note 92.

these phase changes occur within the reservoir and others occur while the hydrocarbons move up the well bore.[95]

As noted above, *Borys* decided the first set of split title questions. What did *Borys* decide? CPR had conveyed title to certain lands, reserving to itself the coal and petroleum. It leased the petroleum rights to Imperial, and while Imperial was in the course of drilling, Borys brought an action to restrain Imperial from continuing its operations on the ground that Imperial's activities would interfere with Borys' rights to the gas. At the time of the action Imperial had not commenced production.

The Privy Council decided that petroleum and natural gas were two separate substances.[96] Borys owned the gas cap gas[97] and CPR owned the petroleum and any natural gas dissolved in the petroleum.[98] The Privy Council also decided that Imperial could continue its drilling operations and could produce Borys' gas cap gas as an incidental part of its operations, provided that it was acting reasonably or in accordance with standard oil field practices.[99] All this was decided against a background regulatory framework that has consistently prohibited the concurrent production of an oil pool with its associated gas cap.[100] In the interests of maximizing recovery, the Energy and Utilities Board ("EUB") and its predecessors will only permit the production of the gas cap once recoverable reserves of oil have been produced.

What then of evolved gas? *Borys* did not decide issues related to evolved gas, but it did suggest that, in construing the CPR reservation, one should do so under reservoir conditions and not surface conditions.[101] Thus in the *Anderson* case, all parties seem to have accepted that it was not open to the plaintiffs to argue that petroleum and natural gas might be divided between the split title holders on the basis of the phase of the substance at the surface.[102]

That option precluded, it was left to the plaintiff gas owners in *Anderson* to argue that ownership of the gas and oil should not be decided under *original* reservoir conditions but should be decided from time to time with ownership divided on the phase of the hydrocarbons as they entered the bottom of the well bore. Fruman J. rejected that argument holding in effect that either Lord Porter had already decided to

95 See *ibid.* at paras. 15-18, 27-35.

96 *Supra* note 93 at 552.

97 *Ibid.*

98 *Ibid.* at 556.

99 *Ibid.* at 559-60.

100 See *supra* note 33, s. 26(1)(e), and the historical antecedents noted by Fruman J. at note 35 of her judgment in *Anderson*, *supra* note 92.

101 Lord Porter indicated in *Borys*, *supra* note 93, at 556, that their Lordships must construe "the meaning which the word "petroleum" bears when the substance referred to is *in situ* in a container below ground." In earlier *dicta*, Lord Porter seemed to contemplate division depending on phase at the surface (at 554), but Fruman J. in *Anderson*, *supra* note 92 at para. 66, dismissed these comments as hypothetical and *obiter*.

102 *Supra* note 92 at para. 66. This concession follows from *Borys*. If the allocation were made at the surface, the gas owner will take solution gas as well as gas cap gas.

the contrary in *Borys*[103] or, at the very least, that any other conclusion would be inconsistent with *Borys* as well as the Alberta Court of Appeal's earlier decision in *Prism Petroleum* v. *Omega Hydrocarbons.*[104]

Fruman J. also went on to decide some ancillary matters. First, she decided that the plaintiffs' entitlement to gas cap gas (decided by *Borys*) also included any gas cap gas produced through the well bore on the plaintiffs' lands that might have migrated from adjoining lands. By the same token, the plaintiffs were not entitled to any evolved gas that might migrate from the adjoining lands.[105] Secondly, the plaintiffs were not entitled to any gas that might evolve from connate water.[106] Thirdly, the plaintiffs were entitled to condensate and natural gas liquids that were dissolved in the primary gas cap gas under initial reservoir conditions but which emerged at the surface as liquids. They were not entitled to such substances if they emerged from the secondary gas cap gas; these substances belonged to the petroleum owner.[107]

While the decision clarifies *Borys*, there are still some difficult issues. First, it is evidently not easy to determine with any precision the entitlement of the respective parties. While it would be a simple matter to effect this division if title were allocated on the basis of phase at the surface, this option has been ruled out, and title must be divided on the basis of initial reservoir conditions.[108]

Secondly, the court provides very little guidance as to how the parties should account for the consequences of the division of ownership which it has confirmed. The court does confirm that the rule of capture is not relevant to oil and gas ownership in split title cases.[109] If one agrees with the court's characterization of the rule of capture as a "no-liability rule,"[110] then it follows that the petroleum owners cannot hide behind the rule of capture and argue that they owe no liability[111] or that they have acquired

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103 *Ibid.* at para. 80.

104 (1994), 18 Alta. L.R. (3d) 225 (C.A.) and discussed in *Anderson, supra* note 92 at paras. 81-89.

105 *Anderson, supra* note 92 at para. 161.

106 *Ibid.* at paras. 162-65. With respect, the superficial reasoning on this point illustrates the political nature of gross allocational decisions such as this. The reason given is little more than that petroleum and water are both liquids, therefore, the petroleum owner should receive the gas evolved from connate water.

107 *Ibid.* at para. 166.

108 Fruman J. deals with these difficulties, *ibid.* at paras. 137-41, and simply concludes that "evaluators can make reasonable engineering estimates of the amount of gas which existed in a primary gas cap, the amount of gas which existed in solution and the amount of gas which evolved from solution in a pool." It might be more accurate to describe these as *guess*timates. The quality of the estimates would be improved if the petroleum owner carried out appropriate tests before commencing production. Can the gas owner argue that there is a duty on the petroleum owner to conduct such tests? If the petroleum owner fails to do so, what inferences might the gas owner be entitled to draw?

109 *Ibid.* at para. 136.

110 *Ibid.* at paras. 130-36.

111 We must accept, however, on the basis of *Borys*, that the gas owner cannot restrain production of gas cap gas provided that the petroleum lessee is acting reasonably. *Dicta* in *Borys, supra* note 93, may go beyond a no-restraint rule, however, insofar as Lord Porter states (at 567) that "some of the gas in the gas cap emerges with the petroleum and the gas owner is thereby deprived of some

ownership of the primary gas cap gas by virtue of capturing it and producing it. But is there a duty to account? Fruman J. has effectively postponed these issues:

> It is unclear to me whether any duty to account arises.
>
> I leave the issue open and permit the parties to readdress it should a duty to account be relevant in the context of my decision. I note that some additional issues have been raised in argument, including the applicability of the *Limitations of Actions Act*, R.S.A. 1980, c. L-15, to limit the obligation to account ... and whether an obligation to account may be reduced by the costs incurred in production and marketing.... At this time I make no determination as to whether these issues are relevant.[112]

Evidently, Fruman J. is a skeptic, but if A is producing B's gas, selling it, and making a profit, why should A not owe B a duty to account even if B is unable to restrain A from producing its gas? Fruman J. cannot be agnostic; if the rule of capture does not apply as between phase owners, then it must follow as a matter of logic that there must be a duty to account.

B. *TAYLOR* v. *SCURRY RAINBOW OIL (SASK.)*[113]

In 1949, Taylor granted a ten-year primary term lease to Imperial. The habendum allowed the lease to continue beyond the end of the primary term "for so long thereafter as the leased substances were produced from the lands." The lease expired at the end of the primary term, but long before that, Taylor granted a document entitled "Assignment and Conveyance of Petroleum and Natural Gas Royalty and Lease of Minerals" to Freeholders Oil ("Freeholders"). The agreement was in a form that is familiar to those practising oil and gas law in Saskatchewan and indeed attracted significant litigation in the 1950s as grantors in the position of Taylor sought to set the agreements aside on the basis of *non est factum*.[114]

The agreement did a number of different things, but for present purposes it is sufficient to focus on paragraph 2 of the agreement, titled "Lease to Grantee." The precise language is important:

> UPON AND IN THE EVENT OF the termination, cancellation, avoidance or expiration of the said drilling lease [the Imperial lease] ... the GRANTOR DOTH HEREBY GRANT AND LEASE UNTO THE GRANTEE all the mines, minerals and mineral rights, ... TO HAVE AND TO ENJOY the same

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of the unreserved property." Fruman J. refers to this passage in *Anderson*, *supra* note 92 at paras. 79-80 of her judgment but does not consider it in the context of the duty to account. In weighing Lord Porter's judgment, it would be nice to know if Lord Porter were operating on the assumption that any gas produced would be flared. If it were to be saved and sold, why should Borys be deprived of his property?

112 *Ibid.* at para. 169.

113 (1998), 170 Sask. R. 222, [1998] S.J. No. 589 (Q.B.), online: QL (SJ) [hereinafter *Taylor*].

114 *Meyers* v. *Freeholders Oil*, [1960] S.C.R. 761.

for a term of ninety-nine (99) years from the date hereof, renewable at the option of the GRANTEE....[115]

Taylor entered into further agreements for the lands with each of Imperial and Freeholders and, while the trial judge refers to those agreements as an aid to the construction of paragraph 2 of the 1950 agreement,[116] mention of them here will only serve to cloud the primary issue. That issue is whether the 1950 Freeholders agreement was void by reason of the common law rule against perpetuities. The interest of Freeholders had become vested in Tarragon Oil and Gas ("Tarragon"). Maxx Petroleum ("Maxx") top-leased the lands in 1993 and, in 1994, launched an application to have the Freeholders-Tarragon caveats vacated.

Saskatchewan has yet to amend or replace the basic common law rule against perpetuities. Thus, the rule applies with full vigour. The rule requires that one be able to determine at the outset that a contingent interest will vest (if at all) within the perpetuity period. The perpetuity period is twenty-one years plus the lives of relevant lives in being (if any). If the rule is breached, the disposition is void.

In the present case there were no relevant lives in being, and it was fairly obvious that the rule was breached *if it applied at all*. Tarragon offered several arguments to lead to the conclusion that the rule did not apply. First, Tarragon argued that its interest under paragraph 2 was not a contingent interest at all. It was vested in interest from the outset. Secondly, the policy behind the rule was not frustrated by this type of agreement, and therefore the rule should not apply. Both arguments failed. The disposition was held to be void from the outset and, since it was void, it could not be saved by subsequent ratification. Neither was Taylor's personal covenant to grant a lease enforceable.[117]

1. CONTINGENT OR VESTED

Tarragon seems to have presented its arguments under this head on two different grounds. The first was a construction argument. The second argument claimed that Freeholders' estate could not be contingent, since any estate that is prevented from taking effect in possession only by the existence of a prior particular estate is, by definition, vested.

2. THE CONSTRUCTION ARGUMENT

Tarragon argued that paragraph 2 was ambiguous. Its preferred interpretation was of a present grant of an interest qualified only by the term (*i.e.* duration) of the interest

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115 The preamble to the agreement indicated that the lease would only be triggered in the event that the Imperial lease expired or was terminated within forty-two years. That provision was not included in the operative part of the agreement, but nothing turns on this point.

116 *Supra* note 113 at paras. 45-48. Gerein J. states that he would have had resort to these subsequent agreements had he found the 1950 agreement to be ambiguous. In fact, he did not, but he does refer to these subsequent agreements to support his conclusion on the construction of para. 2.

117 These last two points are dealt with *ibid.* at paras. 59-60. See *Harris* v. *MNR*, [1966] S.C.R. 489.

taken up by Imperial.[118] In the event of ambiguity, the courts should prefer an interpretation that favours early vesting. Maxx argued that, on its face, the opening words of paragraph 2 created a condition precedent, behind which Tarragon's interest had to be contingent. Gerein J. rejected Tarragon's arguments on this point and did so correctly, given the opening language of paragraph 2 which dominates the words of grant later in that same clause.

3. VESTED AS A MATTER OF LAW

The more interesting argument was whether the interest was vested as a matter of law. An interest is vested (in interest) if the person to take the interest is identifiable *and* if that person is prevented from enjoying the interest in possession merely by the existence of a prior particular estate or estates. Did Freeholders' interest fall within that second exception? Gerein J. held that it did not, but his reasoning is, with respect, far from convincing. Gerein J. devoted just two paragraphs to dismissing this point:

> I have not forgotten the submission that "Contingencies which trigger the operation of the Rule against Perpetuities are contingencies other than the termination of the prior estate however and whenever they may occur." ... I do not quarrel with that statement as a general proposition. If a grantor gives to A with a remainder to B ... there is no condition and there is an immediate vesting.
>
> However that does not mean that a grantor cannot impose a condition based upon termination of a prior estate. In the instant case, had the parties not used the particular opening terminology, there would be no condition or contingency and the submission would have merit. However, they did not do that, but rather chose to use terminology which created a situation of contingency and futurity.[119]

The most serious doctrinal question for Gerein J. was one that he never posed: namely, was the Imperial interest a prior particular estate within the meaning of the vesting rule? He seems to assume that it was, but the literature generally works on the basis that the prior estate must be some form of life estate because one cannot have a remainder after a fee and it is no longer possible to create an estate tail.[120]

The oil and gas lease may be a hybrid form of interest, but nobody would suggest that it is a life estate. It is not a true lease, and is, as a matter of law, a *profit à prendre*.[121] However, it still must be granted for some estate known to the law.[122] Given the uncertainty of its duration, it cannot be a lease, and it is most likely some

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118 On this view, Freeholders' ninety-nine year term simply had carved out of it the Imperial interest, however long it might turn out to be.

119 *Supra* note 113 at paras. 43-44.

120 A disposition after a fee tail was treated as vested. See A.H. Oosterhoff and W.B. Rayner, *Anger and Honsberger Law of Real Property*, vol. 1, 2d ed. (Aurora, Ont.: Canada Law Book, 1985) at 489.

121 *Berkheiser* v. *Berkheiser*, [1957] S.C.R. 387 [hereinafter *Berkheiser*].

122 The same is true of other incorporeal interests. For an amusing example, see *Miller* v. *Emcer Products*, [1956] Ch. 304 (C.A.), dealing with a lease of an easement to use a lavatory. But see also the discussion in *Berkheiser*, *supra* note 121, and Laskin J.'s judgment in *Saskatchewan Minerals* v. *Keyes*, [1972] 2 W.W.R. 108 (S.C.C.) at 118-21 (dissenting, but not on this point).

form of determinable fee. What does the common law say about a disposition that follows a determinable or conditional fee? Megarry and Wade are clear: remainders that follow a determinable or conditional fee will be contingent. They give the following example and explanation:

> [I]f the gift had been -
>
> > "To A (a bachelor) for life, remainder to his eldest son (if any) in fee simple, remainder to B in fee simple,"
>
> B's remainder would have been contingent, for there was a rule that no interest which followed a contingent fee simple could be vested. This was because although a grantor can create any number of successive life interests or entails (limited interests) and vest them in living persons, he can part with the fee simple (an absolute interest) only once; so that any two limitations of the fee simple are not successive but alternative, and if one is contingent the other must depend on the converse contingency. For somewhat similar reasons a gift which follows a determinable or conditional fee simple is regarded as contingent, as for example B's interest in a limitation —
>
> > "to A in fee simple until he ceases to reside in the family home, remainder to B in fee simple."[123]

Thus, notwithstanding the well-known exception that the possibility of reverter is a vested interest that is not subject to the rule, the purported disposition of the remainder after the determinable interest is treated as contingent. In the present case, Taylor did not grant Freeholders his possibility of reverter; he granted Freeholders an estate that could only take effect on the determination of the prior estate, an event that might never happen.

4. PUBLIC POLICY

In addition to these technical arguments, the defendants also made the case that the type of agreement at issue here did not offend the policy behind the rule and therefore should not offend the rule. Top-leases of this sort do not remove land from the market and productive economic activity; in fact, they encourage development of the property.[124] Gerein J. seemed quite prepared to accept the substantive claim underlying this argument but took the view that he would be exceeding his judicial authority if he were to set aside the rule. This was especially the case in Saskatchewan given that the Law Reform Commission had recommended abolition in 1987, but a bill to give effect to that recommendation died on the order paper.[125]

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123 R. Megarry and H.W.R. Wade, *The Law of Real Property*, 4th ed. (London: Stevens, 1975) at 175-76 [footnotes omitted].

124 *Supra* note 113 at paras. 53-54.

125 *Ibid.* at paras. 52, 55, 56.

C. *PADDON HUGHES DEVELOPMENT* V. *PANCONTINENTAL OIL*[126]

The Alberta Court of Appeal handed down its split decision in *Panco* in October 1998. The primary issue was the construction of the manner of payment clause.

Pancontinental Oil Ltd. ("Panco") held three leases to the southeast quarter, each as to an undivided one-third interest. Each of the leases was an "unless" lease for a primary term of five years with an anniversary date in the case of the Bishop lease of August 17, and in the case of the Thatcher lease of August 19. Paddon Hughes Development Co. ("Paddon Hughes") had acquired the interest of the original lessors. The lands in question were pooled with other lands in the section, and a well was drilled on the northwest quarter. The question in the earlier case was whether there was a valid pooling agreement in effect by the end of the primary term of each of the southeast quarter leases. Rooke J. held that the pooling was in place and accordingly that ground of attack failed.[127]

By the time the case reached the Alberta Court of Appeal, the issue had narrowed to the legal effect of the tender of a delay rental that had been made under the Thatcher lease during the first year of the primary term (1985). The parties conceded that, if there were a late payment of a delay rental on either of the Bishop or Thatcher leases, that would cause the entire pooling arrangement to unravel.

The facts relevant to this issue were as follows: Thatcher lived in California. He had insisted on a change to the manner of payment clause in the Panco lease form. The clause in Panco's standard form provided that a payment to the Lessor: (1) might be paid or tendered either to the lessor or the named depositary; (2) by cheque or draft of the lessee; (3) mailed or delivered; and (4) in Canadian funds. Most importantly, the clause had a deeming provision to the effect that "[i]n the case of payments which are mailed, such payments shall be deemed to be received by the Lessor as of the date of mailing...."

The clause was revised by striking out certain words and by inserting handwritten additions. As a result of the changes, the Thatcher clause ultimately read as follows:

> 21. Manner of Payment
>
> All payments to the Lessor provided for in this Lease shall be paid to the Lessor at the address specified in Paragraph 24.

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126 (1998), 223 A.R. 180, [1998] A.J. No. 1120 (C.A.), online: QL (AJ), aff'g (1995), 33 Alta. L.R. (3d) 7, [1995] 10 W.W.R. 656 (Q.B.) [hereinafter *Panco*]. For the earlier litigation raising pooling issues, see *Paddon Hughes Development* v. *Pancontinental Oil* (1992), 2 Alta. L.R. (3d) 343, [1992] 5 W.W.R. 106 (Q.B.). This case was commented on in N. Bankes, "Pooling Agreements in Canadian Oil and Gas Law" (1995) 33 Alta. L. Rev. 945.

127 *Ibid.*

Paragraph 24 was the lease clause specifying how notices were to be delivered. It provided:

> 24. Notices
>
> All notices to be given hereunder may be given by registered letter addressed to ... the Lessor at San Francisco, California, USA 94110 507 Peralata Avenue, or such other address as the Lessor ... may ... from time to time appoint in writing, and any such notice shall be deemed to be given to and received by the addressee seven (7) days after the mailing thereof, postage prepaid.

The trial judge concluded that a cheque to each of Stevens and Thatcher was mailed by regular mail on 9 August 1985. The evidence on the point was somewhat equivocal,[128] but both the majority and the dissent in the court of appeal found that there was no palpable or overriding error in this determination and therefore no basis on which to overturn the trial decision.[129] Beyond that, the evidence of payment was that while there was no evidence of the usual time required for deliveries between Calgary and San Francisco, there was evidence to the effect that other payments sent by mail by Panco to Thatcher took less than eleven days.

Panco's argument was therefore three-fold. First, as a matter of construction of the lease as amended, the lease contemplated use of the mail for payment of delay rental. Secondly, given that mailing was contemplated, payment should be deemed to have been made when posted. Thirdly, and in the alternative, there was evidence on which it could be inferred that if the cheque were posted on August 9 it would have been received by Thatcher before August 20.

There was a preliminary issue to deal with before the court of appeal could consider these three arguments: what use was the court entitled to make of the struck-out portion of the manner of payment clause? On that issue, O'Leary J., for the majority, was clear. In the absence of ambiguity it was not appropriate to refer to the deleted words to establish the meaning of the words actually used by the parties. There was no ambiguity here, so "the words deleted from the Thatcher lease are to be ignored and treated as if they never existed."[130]

That issue disposed of, what did clause 21 contemplate? First, the majority took the view that the clause certainly contemplated payment by mail. This interpretation was consistent with the incorporation by reference of the notice clause of the lease with its stipulation of a zip code. The interpretation was also consistent with commercial reality given the small sums involved and the distance between the parties. The court, said O'Leary J., should attribute to contracting parties a businesslike intention. To permit

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128 Bishop's designated depositary acknowledged receipt on August 26, while Thatcher acknowledged receipt on September 4. There was evidence from Bishop's depositary that the cheque would have been received August 25 or 26 and evidence from Canada Post that average delivery between Edmonton and Calgary for that time was between two and three days.

129 *Supra* note 126 at paras. 21, 75.

130 *Ibid.* at para. 34.

payment by mail was not to imply a term into the contract; it was merely finding the proper interpretation of the agreement between the parties.[131]

The distinction was an important one given the inclusion of the standard entirety clause in the lease. An entirety clause prevents a court from reading additional terms into the lease, but it does not prevent a court from determining what the entire agreement means. In particular, it cannot preclude a court from determining what the words "paid to the Lessor at the address specified" actually mean.[132] O'Leary J. summarizes the point well:

> The conclusion that the Thatcher lease contemplates payment of the delay rental by mail is not based on extrinsic evidence of the parties' intentions, and therefore does not offend the parole evidence rule. Even if clause 23 of the Thatcher lease [the entire agreement clause] is broader than the parole evidence rule, the conclusion does not amount to "an implied covenant or liability of any kind." Construing the Thatcher lease as evincing a contractual intention that Pancontinental may pay the delay rental by mail does not amount to finding a collateral agreement over and above the written lease, nor does it impose any obligations beyond those already contained in the agreement.[133]

But if the agreement contemplated payment by mail, when is such a payment received? Following an analysis of the authorities, O'Leary J. held that where a lease permits payment by mail, payment is made when posted. The authorities analyzed included a United States oil and gas case and two Canadian lease authorities: *Texas Gulf Sulphur* v. *Ballem*[134] and *Paramount Petroleum and Mineral* v. *Imperial Oil.*[135] In each of these cases, clauses that contemplated payment by mail were held to contemplate that payment occurred upon mailing. *Canadian Fina Oil Ltd.* v. *Pashke*[136] apparently supported Paddon Hughes' position but was distinguished on the basis that, in that case, the lease in question had already expired before the cheque was mailed.[137]

The majority was also prepared to dismiss the appeal on the alternative grounds that the evidence justified an inference that a cheque mailed in Calgary on August 9 would have arrived "well before the anniversary date."[138] All parties conceded that it would be enough if the cheque were delivered to the specified address. Proof of personal receipt by Thatcher was not necessary.[139]

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131 *Ibid.* at paras. 38-41. Consistent with this approach, see *Merger Restaurants* v. *Lakeview Development of Canada*, [1990] 5 W.W.R. 489 (Man. C.A.).

132 *Panco*, *supra* note 126 at para. 46.

133 *Ibid.* at para. 45.

134 (1970), 72 W.W.R. 273 (Alta. S.C.(A.D.)), aff'd [1971] 1 W.W.R. 560 (S.C.C.) [hereinafter *Texas Gulf*].

135 (1970), 73 W.W.R. 417 (Sask. Q.B.).

136 (1957), 21 W.W.R. 260 (Alta. S.C.(A.D.)).

137 *Panco*, *supra* note 126 at para. 60.

138 *Ibid.* at para. 62.

139 *Ibid.* at para. 56.

Côté J. offered a vigorous dissent; it must be concluded that he dissented both on the grounds that mailing a cheque does not constitute delivery and also on the grounds that the lease should not be interpreted as permitting payment by mail.

This appears so for two reasons. First, if Côté J. contemplated that payment by mail delivered at the Thatcher address was acceptable, he needed to consider Panco's alternative argument prior to allowing the appeal. On the interpretation of the evidence offered by both the trial judge and O'Leary J., Panco did not need to establish that payment occurred on posting. Secondly, although his primary target is the proposition that mailing equals delivery, some of Côté J.'s comments speak more broadly:

> To hold that the Thatcher lease intended or permitted the payment to be mailed would be an error of law ... [140]

> [T]he Thatcher lease does not mention mailing payments. It says that the money shall be paid to the Lessor at the address specified. How can one then hold that the contract called for mailing, and not any other means of delivery. [141]

Côté J. does score some important points on the postal rule. He questioned the commercial reality of those who assert that mailing equals payment even if there is never a delivery, and he argued that the offer and acceptance cases are not relevant, since this is a case of payment and not an acceptance case.[142]

But even if one applies the offer and acceptance cases, it is clear that the postal rule will not always be incorporated. The point is well made in the decision of the English Court of Appeal in *Holwell Securities* v. *Hughes*.[143] In that case, Holwell Securities Ltd. had an option to renew a lease. The agreement provided that "[t]he said option shall be exercisable by notice in writing to the [defendant] at any time within six months from the date hereof...." The parties agreed that the plaintiff purported to accept the offer by mailing a letter to the defendant some four or five days before expiry of

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140 *Ibid.* at para. 85.

141 *Ibid.* at para. 88.

142 But, if one characterizes the delay rental clause in an unless lease as an option (as the courts have: see *East Crest Oil* v. *Strohschein*, [1952] 2 D.L.R. 432 (Alta. S.C.(A.D.)), tendering (or, more precisely making) payment is an acceptance of the option. This point was actually taken by Cairns J. in *Texas Gulf, supra* note 134 at 283: "An option is nothing more than an offer and the manner of acceptance is stated therein and when it is specified how it may be accomplished, namely, by mail, then the date of posting is the date of acceptance. That is to say, in this case the posting of the letter containing the cheque is acceptance of the offer contained in the option."

143 [1974] 1 All E.R. 161 (C.A.) [hereinafter *Holwell Securities*]. This case was drawn to the authors' attention by Bankes' colleague Nick Rafferty. It is not cited in either the trial judgment, [1995] 10 W.W.R. 656, or in the Court of Appeal. However, Côté J. does refer to the Supreme Court of Canada's decision in *Saskatchewan River Bungalows* v. *Maritime Life Insurance*, [1994] 7 W.W.R. 37 (S.C.C.). There, the Supreme Court of Canada proceeded on the basis that the court of appeal was correct in its holding that a contract term making monies "payable ... at the Head Office of the Company" was sufficient to displace the postal rule. In reaching that conclusion, the court of appeal had relied on *Holwell Securities*.

the six-month period.[144] The letter went astray and was never delivered, although a copy of the letter was delivered that same day to the defendant's solicitor.

The Court of Appeal agreed that the postal service could be used to communicate acceptance of the offer (by exercise of the option), but the court also concluded that the parties did not contemplate application of the postal rule. Instead, the words used indicated that they expected actual communication. Russell L.J. emphasized that the option used the words "notice ... to" and that this was "language which should be taken expressly to assert the ordinary situation in law that acceptance requires to be communicated or notified to the offeror, and is inconsistent with the theory that acceptance be constituted by the act of posting referred to by Anson as 'acceptance *without notification*'."[145]

Lawton L.J. was even more direct. It was clear to him that the postal rule would not apply in all circumstances where the parties would have expected the post to be used as the means of accepting an offer:

> First, it does not apply when the express terms of the offer specify that the acceptance must reach the offeror.... Secondly, it probably does not operate if its application would produce manifest inconvenience and absurdity.[146]
>
> [Examples follow]
>
> In my judgment the factors of inconvenience and absurdity are but illustrations of a wider principle, namely, that the rule does not apply if, having regard to all the circumstances, including the nature of the subject matter under consideration, the negotiating parties cannot have intended that there should be a binding agreement until the party accepting an offer or exercising an option had in fact communicated the acceptance or exercise to the other.[147]

In *Panco*, the language of the clause to which the parties agreed is even more compelling. Thus the parties agreed that all payments "shall be paid" at a prescribed address. *Holwell Securities* suggests that a court will not need much convincing that the parties had intended to reject the mailing rule even where they contemplated use of the mail. *Holwell Securities* involved a mere notice and not payment. It seems hard to reach the conclusion that the terms of an option that requires a payment have been fulfilled, even if payment is never received by the lessor. That was not this case since all parties acknowledged that payment was ultimately received, but implicitly O'Leary J. must also be taken to have decided the harder case as well.

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144 The letter was mailed on the fourteenth of the month right at the end of the six-month period; the lease was dated the 19th. Presumably the six months expired either on the 19th or at midnight on the 18th.

145 *Panco, supra* note 126 at 164. [Emphasis in original, footnotes omitted].

146 *Ibid.* at 166.

147 *Ibid.* at 167.

D. *DURISH V. WHITE RESOURCE MANAGEMENT*[148]

1. THE FACTS

White Resource Management ("White") and Durish maintained competing titles to a quarter section of land. The facts are very complex, but for the purposes of the lease issues it seems enough to say that Durish claimed an interest under the Pawnee/Haida lease, granted 25 November 1971, which was prior in time to the Vold-White lease, granted 27 May 1978, under which White claimed. Lobell, a company controlled by Durish, drilled a well on the lands in 1979. The well was successful, although it was shut in for lack of a market until 1982. Lobell acquired its interest in the Vold-White lease by way of a farmout from White to Durish (25 October 1978), which Durish assigned to Lobell before the well was drilled. After Lobell had successfully drilled the well, White, through WRM Resources ("WRM"), expressed an interest in re-acquiring Lobell's 50 percent interest as well as Durish's freehold interest. The parties entered into two purchase and sale agreements and proceeded to simultaneous completion of the two agreements. White and Lobell closed the sale for the working interest in June 1981 but the sale of the freehold title fell through. As a result, Durish maintained on title a caveat protecting the Pawnee/Haida lease. WRM paid the proceeds of production from the well to the Royal Bank pursuant to a s. 177 *Bank Act* security.

Durish had acquired a personal interest in the competing Pawnee/Haida lease in May 1979 when he became aware of Pawnee's competing interest shortly before Lobell was to drill the well. He had also taken steps in April 1979 to acquire the freehold interest in the lands.

Upon Durish's refusal to affirm WRM's working interest title, White commenced the original action seeking a declaration as to the validity of its petroleum and natural gas interest. Durish defended and counterclaimed. Durish based his claim on the Pawnee/Haida lease and named the Royal Bank as a defendant on the grounds that the bank had full knowledge of his interest by virtue of his caveat and was therefore liable to account to him for all of the proceeds.

The first matter to proceed was Durish's counterclaim, and at the close of Durish's case the defendants moved for a non-suit. The defendants succeeded before Mason J.[149] and the Alberta Court of Appeal,[150] but lost before the Supreme Court of Canada.[151] The Supreme Court of Canada held that, in principle, Durish's claim to priority under the Pawnee/Haida caveat was superior to that claimed by the White interests. However, since a caveat is only notice of an interest, the matter was sent back to trial to determine the validity of the lease and also to determine what claim Durish and other parties might have to the production revenue if the lease were valid.[152]

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148 [1998] A.J. No. 1041 (Q.B.), online: QL (AJ) [hereinafter *Durish*].
149 (1990), 77 Alta. L.R. (2d) 131 (Q.B.).
150 [1993] 1 W.W.R. 752 (Alta. C.A.).
151 (1995), 26 Alta. L.R. (3d) 155 (S.C.C.).
152 *Ibid.* at para. 40.

Upon trial of the remaining issues, Durish's counterclaim was comprehensively dismissed for two reasons. First, Durish failed on the basis that any priority based on the Pawnee/Haida lease was doomed because that lease had in fact expired in accordance with its own terms for failing to drill or alternatively, having drilled, for failing to make a timely shut-in royalty payment.

Secondly, Durish failed because, even if the Pawnee/Haida lease had survived, he could not enforce his claim for production revenue under that lease against either White or the Royal Bank. This conclusion is based upon several alternative grounds.[153] First, in acquiring the Pawnee/Haida lease in his personal capacity, Durish was capturing a corporate opportunity that should have flowed to Lobell, a corporation of which Durish was a director. Durish held any benefits he acquired as a constructive trustee for Lobell. WRM was the successor in title to Lobell and succeeded to any right of action that Lobell might have based upon Durish's breach of fiduciary duty. Secondly, when Lobell conveyed its working interest in the subject lands back to WRM, Durish signed a certificate in which he represented in his personal capacity that, to the best of his information, knowledge, and belief, he was unaware of any adverse claims or interests relating to the property. Having made that representation, he was estopped from denying its validity once it had been relied upon by WRM in completing the transaction.

2. THE DRILLING OBLIGATION

In maintaining his claim under the Pawnee/Haida lease, Durish faced the obstacle that the persons beneficially entitled under the Pawnee/Haida lease had never drilled a well on the lands. Could Durish claim that a well drilled on the same lands, but by another party (Lobell) and under a competing lease, could satisfy the drilling obligation for the primary term? Durish's lease did not state, as some leases do, that the lessee or a person authorized by the lessee must drill the well. Nevertheless, Mason J. ruled that the result was the same because this conclusion was the most consistent with the underlying purpose of the lease. Relying exclusively upon American authority, Mason J. concluded that the lease was intended to secure the exploration of the property by the lessee. Any other construction allows the lessee to hold the property for speculative purposes. Rival lessees could enter into an agreement that might satisfy the requirements of more than one lease, but passivity was insufficient, "Durish would have had to contribute to the expense of drilling, or have some kind of formal arrangement which he did not."[154]

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153 See also the discussion in section VI. D., below. There were two other issues not commented on here. First, Mason J. held that the release signed by Haida could be relied upon not only by Durish but also by WRM. As a result, Durish could not resurrect the Pawnee/Haida lease and assert it against WRM. Secondly, even if Durish might have a claim against White or WRM, it had no claim against the Royal Bank as the bank was not an express trustee and had not knowingly assisted in a breach of trust by another party.

154 *Supra* note 151, at para. 47. Note that even if one could argue that there was an informal arrangement between Durish and Lobell (which Durish controlled), that might not have helped Durish given the fiduciary argument considered in section VI.D. below.

3. LATE PAYMENT OF SHUT-IN ROYALTY

Even if Durish could rely on drilling operations under a competing lease, he faced the further obstacle that the well was subsequently shut in during the primary term, and that there had been no payment of a shut-in royalty. Durish sought to argue that a shut-in royalty was not necessary because of the language of the third proviso.

The third proviso began with the words "AND FURTHER ALWAYS PROVIDED THAT if *at the end of the said ... term*." A further sub-proviso within that clause (separated by a semi-colon) went on to state that if a well on the lands or the pooled lands was "shut-in, suspended or otherwise not produced as the result of a lack of or an intermittent market, or of any cause whatsoever beyond the lessee's reasonable control, *the time of such interruption or suspension or non-production shall not be counted against the Lessee*, anything hereinbefore contained or implied to the contrary notwithstanding" [emphasis added]. The shut-in well clause provided that, in the event of a shut-in well, the lessee may pay a royalty in an amount equal to the delay rental and, upon timely payment, the well would be deemed to be a producing well.

Relying on *McLean Oil Properties* v. *Kissinger Petroleums*,[155] Durish argued that time should not run against him and that therefore the lease could not have terminated under its own terms.[156] Mason J. chose to rely on the opening language of the clause and pointed out that the third proviso spoke only to the situation at the end of the primary term. It must have been his view, although he does not expressly deal with the point, that the opening words must control the sub-proviso notwithstanding the semi-colon separating that sub-clause. This conclusion is reinforced by the "option" language of the shut-in clause which also speaks to the circumstances under which a well is deemed to be a producing well for the purposes of continuing the lease. Mason J. did not need to rely on that clause as an aid in interpreting the third proviso and did not do so. In his view, the third proviso was simply not engaged; the shut-in well clause governed and had not been complied with.[157]

155 (1984), 13 D.L.R. (4th) 542 (Alta. C.A.).

156 There is another argument that might have been available to Durish. This is the claim that once a well has been drilled, there is nothing in the *habendum* or the provisos that requires anything more to be done before the end of the primary term in order to keep the lease in force. In particular, the lessee is not required to make a shut-in payment to maintain the lease in force. The argument must turn on the specific language of the lease, but in this case one can make the following points: (1) the *habendum* provides for a ten-year primary term subject to sooner termination under the three provisos; (2) the first proviso requires drilling or payment (for present purposes, assume drilling); (3) the second proviso deals with the abandonment of a well drilled during the primary term (note in this case that the well was capable of production and subsequently proved it); and (4) the third proviso deals with the situation at the end of the term (not in this case). *Ergo* the lease was not subject to sooner termination. Durish had done all that was necessary to keep this lease in force, *all on the assumption that he could rely on the Lobell well*. In the present case, the argument is weakened somewhat by the language of the shut-in wells clause since that clause purports to apply both during and after the primary term.

157 *Supra* note 148 at para. 53.

These findings were actually sufficient to dispose of Durish's claims, but Mason J. went on to deal with the other arguments of the defendants. Even if Durish's lease were invalid, he still had to establish that he was entitled to the fruits of the well. Mason J. decided that he was not.

4. ESTOPPEL BY REPRESENTATION

On the assumption that the Pawnee/Haida lease was valid, and on the further assumption that for some reason Durish was not a constructive trustee of the profits for Lobell and WRM (see section VI.D, below), Mason J. went on to hold that, in any event, Durish was estopped from asserting the priority of the Pawnee/Durish title against WRM by reason of certain representations made by Durish, in his personal capacity, at the time of closing the sale of the working interest from Lobell to WRM.

What were those representations? There was no warranty as to title in the WRM/Lobell working interest sale agreement, but under clause 7, Lobell was required to represent, to the best of the knowledge, information, and belief of the vendor, that: (1) there were no royalties or other encumbrances other than those disclosed; (2) it is the holder of at least the identified working interest and that the properties will be free of encumbrances except through instruments by which the vendor derives title; (3) there are no charges, claims, or actions in existence, contemplated, or threatened; and (4) there are no outstanding rights of first refusal.[158] In addition, by letter setting up the closing meeting, Durish's solicitor represented that discharges for three caveats had been prepared, and, in the event that one was not registered by closing, there was an undertaking to do so forthwith.[159] Durish's interest in the Haida lease was disclosed on title by caveat, but counsel for WRM testified that he did not consider the caveat further since he assumed that it could not be material in light of the discontinuance of the action that Haida had commenced. The discontinuance was in response to a notice to take proceedings on a caveat that White had initiated some time previously.

Although the agreement pertaining to the sale of the working interest was the only agreement to close, there was a second agreement, pursuant to which Durish agreed to sell his interest in the freehold estate. This agreement did not close but the original intent was that both agreements would close at the same time.[160]

In the course of closing the sale of the Lobell working interest, counsel for WRM insisted that Durish execute a certificate. In that document "I ... Durish, the President of [Lobell]" certified *inter alia* that:

> 4. To the best of my knowledge, information and belief the Vendor has full right, title and beneficial interest in and to the said Properties ... and I am unaware of any adverse claims or interests therein or relating thereto.[161]

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[158] *Ibid.* at para. 153.
[159] *Ibid.* at para. 160.
[160] *Ibid.*
[161] *Ibid.* at para. 164.

On the basis of these and other facts, Mason J. concluded that Durish was estopped from claiming title.

Several issues proved to be contentious but were largely resolved on the basis of findings of fact adverse to Durish. First, Durish contended that WRM either knew that he had an interest in the Pawnee/Haida lease or should have known since WRM had conducted a title review and knew of the caveats protecting the Pawnee/Haida lease. The court held that WRM had no knowledge of Durish's interest. While WRM's lawyer "may not have been completely thorough"[162] by failing to look behind the caveats and by assuming that the underlying interests had been dissolved by the discontinuance of action, it was not unreasonable for him to have failed to do so. These findings were important because they were an effective response to Durish's claim that there could not be a misrepresentation if WRM knew the true facts.[163]

Secondly, Durish claimed that at the relevant time, the time of closing, the representations were true. Durish fully intended to discharge the Pawnee/Haida caveats, and it was only after the twin agreement dealing with the freehold mineral title went sour that Durish changed his mind. That argument did not sit well with the court. In Mason J.'s view, at some time during the closing meeting, if not before, it became apparent that both deals would not close simultaneously as had originally been contemplated. Consequently, Durish should have qualified his statements accordingly.

Thirdly, Durish argued that he executed the certificate on behalf of Lobell and not in his personal capacity. On that argument Mason J. ruled that the drafting was clear and that other evidence tended to establish that he had been asked to sign in his personal capacity.

In sum, all the elements of an estoppel were present:

> In the certificate Durish clearly stated that within his own personal knowledge, that he was not aware of any adverse interests on title. WRM acted on that representation by proceeding to close the deal with Lobell and, subsequently, it continued to drill on the lands. Having made that representation, Durish must now abide by the consequences which is that he is now estopped from asserting a claim which contradicts the representation made in the certificate. It is equitable to apply the doctrine of estoppel to prevent him from befitting from his inequitable behaviour.[164]

This case offers several lessons. First, it shows the risks associated with simply assuming, without investigation, that a caveat protects some interest and that the interest has somehow expired or is no longer relevant. The only prudent course of action is to have the vendor discharge the caveat before closing.[165] Having failed to ascertain

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162 *Ibid.* at para. 185.

163 See *Conmac Western Industries* v. *Robinson,* [1993] 6 W.W.R. 375 (Alta. Q.B.) discussed *ibid.* at para. 168.

164 *Supra* note 148 at para. 195.

165 An alternative might be to take an assignment of the caveat as permitted by s. 135.1 of the *Land Titles Act,* R.S.A. 1980, c. L-5.

precisely what the caveat was protecting, WRM's lawyer was fortunate that his client suffered no loss in the final analysis. Secondly, the case is a nice illustration of the value of obtaining representations from both the corporate entity and the individuals if there is any risk of a dual interest in the property. Had Durish executed the representation simply on behalf of Lobell, this argument would have been lost.

E. *ALBERTA (ENERGY RESOURCES CONSERVATION BOARD)* V. *SARG OILS*[166]

The issues in *Sarg* (the facts of which are dealt with in more detail above) included the potential liability of the two solicitors who were involved in the Sarg-Sundial transaction. On the assumption that the Board could recover its abandonment costs from Sarg, could Sarg recover from Naimish (Sarg's solicitor on the sale to Sundial) on the basis of alleged negligence, or from Dent, Sundial's solicitor, on the basis of a breach of trust conditions?

1. TRUST CONDITIONS

The relevant facts for these issues were as follows. On April 29, pursuant to the sale agreement, Naimish wrote to Dent enclosing a series of documents, including transfers of well licences. These documents were forwarded in trust for execution by Sundial on the condition that no use be made of the documents until after Dent returned to Naimish executed copies of the documents along with the balance of the purchase price. It was understood that, once executed, Dent would submit the transfers to the ERCB for its approval. Dent responded on May 11 with some of the executed documents and the balance of the monies. The executed documents cannot have included the well licence transfers. Dent reminded his client of the need to forward copies of the filed transfers, and on May 27, Naimish confirmed that he was disbursing the purchase monies to Sarg and reminding Dent of the need to get filed copies of the documents.

Counsel for Sarg alleged that Dent had breached the trust conditions because he had made use of the documentation before providing Sarg with filed copies of the transfers. Dent argued that Sarg's claim to copies of filed documents was a post-closing, post-trust matter.[167]

Lutz J. agreed with Dent:

> The interpretation suggested by counsel for Sarg is not reasonable because it would have been unreasonable for Naimish to have attempted to impose on Mr. Dent an obligation to obtain consent to the ERCB to the transfer. A lawyer cannot guarantee the future consent of a third party and Naimish would have known this.[168]

Furthermore, given the ERCB's practice as known to the parties at the time, there was no reason for the lawyers to have imposed such a trust condition. The trust

166 *Supra* note 32.
167 *Ibid.* at paras. 214-15.
168 *Ibid.* at para. 218.

conditions were imposed to prevent Sundial from taking title without paying and not for the broader purpose now asserted by Sarg.

2. THE NEGLIGENCE ISSUE

The evidence showed that Naimish proceeded in accordance with normal conveyancing practice at the time.[169]

> It was the normal practice in the industry to deal with the licence transfers in due course. Refusals by the ERCB for well licence transfers were practically unheard of in cases where the paperwork was in order and the fees had been paid; therefore, there was little perceived risk in proceeding by normal practice.[170]

The agreement contained an indemnity clause designed to protect Sarg from liability for future clean-up expenses.

The court concluded that in order to escape liability a professional must show not only that he or she followed general practice in the industry, but also that the general practice reflects reasonable and diligent conduct.[171] In answering that second element, Lutz J. applied the three-fold test articulated by the Privy Council in *Edward Wong Finance Co.* v. *Johnson Stokes*:[172] (1) does the practice involve a foreseeable risk in the particular case; (2) if yes, could the risk be avoided; and (3) was it negligent to fail to take avoiding action?

In the instant case it was clear that there was a foreseeable risk, although the parties undoubtedly assessed the risk as small. But the crux was that there was no way for Naimish to avoid the risk.

> The ERCB has no mechanism for pre-approving an applicant for a well licence transfer. The *OGCA* requires that an applicant for a well licence transfer be the owner of the wells in question. Consequently, the sale of the wells from Sarg to Sundial had to be completed before the licence transfer process was undertaken. Naimish proceeded in the best way possible under the circumstances and his conduct certainly did not fall below the standard of care a solicitor owes to his client. The Sarg to Sundial well sale turned out badly for Sarg; however, it is not for a solicitor to make good his client's bad business deals.[173]

The ERCB's practice has changed somewhat since the events described by Lutz J. In particular, the ERCB now screens both the transferor and a transferee of a well licence to determine if both parties will meet the "well-screening ratio."[174] Under the well- screening ratio, the ERCB examines the ratio of active versus inactive wells. If

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169 *Ibid.* at para. 207.
170 *Ibid.* at para. 206.
171 *Ibid.* at para. 209, citing *Roberge* v. *Bolduc* (1991), 78 D.L.R. (4th) 666 (S.C.C.).
172 [1984] 1 A.C. 296 (P.C.).
173 *Sarg*, *supra* note 32 at para. 213.
174 ERCB, Interim Directive ID 93-2, "Requirements for the Issuance of a Well Licence or Approval of Well Licence Transfers" (2 July 1993).

the ratio of active to inactive wells for the transferor or transferee is less than one, the ERCB will proceed to a more detailed review. The standards are described in the ERCB's information letters and interim directives, and they can be self-applied. As a result, it is perfectly reasonable for the vendor and purchaser each to represent that they have reviewed the ERCB's rules and applied the well-screening ratio and that they believe themselves to be in compliance. This of course could not be a representation that the ERCB will approve the transfer, but it does provide additional certainty and protection to the parties. Other possible mechanisms include the use of an escrow agent to hold the title documents pending approval of the licence transfers and the execution of re-transfer documents; however, both of these mechanisms are complex and create difficult accounting problems for production that occurs in the interim if the deal fails.

F. *KAISER FRANCIS OIL COMPANY OF CANADA* V. *BEARSPAW PETROLEUM*[175]

This decision is primarily concerned with replacement of an operator under a non-standard operating agreement. However, in the course of his judgment, Sullivan J. also had to decide whether Norcen Energy Resources Ltd. ("Norcen"), the designated operator, had assigned the operatorship as part of the general conveyancing language of its agreement of purchase and sale with Bearspaw Petroleum Ltd. ("Bearspaw"). Under that agreement, Norcen purported to transfer the vendor's interests in the assets "subject to encumbrances." The assets included "the entire interest" of the vendor in "all contracts, agreements ... including ... operating agreements." Was the operatorship part of the entire interest of the vendor even though a transfer required consent?

Yes, answered Sullivan J.:[176]

> [I]t would be misstating the nature of the operating agreement to say that Norcen's role therein was not part of its interest. It just happens that it is, on the language of the agreement, not one that is transferrable without the consent of the other party. While ... it is true that Norcen's interest does not include an *unrestricted ability to transfer* operatorship, it cannot ... be said that the *operatorship itself* was not part of its interest. The only way to reach this conclusion ... would be to construe "entire interest of the vendor" as meaning "entire *legally transferrable* interest of the vendor" ...

That was not the end of the story. In order to find for Bearspaw, the court also had to decide whether the Kaiser Francis Oil Company ("Kaiser") consent requirement was an encumbrance excepted out of the transfer. The agreement defined "permitted encumbrances" to include "preferential rights," which were in turn defined as "each right of first refusal, preferential right of purchase or pre-emptive right requiring the procurement of a waiver from a third party prior to the disposition of any of the Assets." Sullivan J. was of the view that Kaiser's right to withhold consent, especially

175 [1999] A.J. No. 153 (Q.B.), online: QL (AJ). for a recital of the facts, see section IV.C. below.

176 *Ibid.* at para. 57 [emphasis in original].

when combined with its right of challenge, was such a preferential right.[177] This is clearly a broad interpretation of a right of first refusal but no doubt justified in this case by the rather broader language of "procurement of a waiver" that follows the specific listing of different types of pre-emptive rights. The court went on to note that its interpretation was confirmed by the actual practice of the parties.

G. *LIEBING* v. *ALBERTA (REGISTRAR OF THE NORTH ALBERTA LAND REGISTRATION DISTRICT)*[178]

Henry Liebing ("HCL") was in default of his municipal tax assessment and the Municipal District of Melrose acquired title to HCL's lands pursuant to the *Tax Recovery Act*.[179] Liebing took a transfer from the municipality and the registrar issued a certificate of title to Liebing, including mines and minerals, except coal. Liebing sold the property to King. The Liebing-King transfer reserved mines and minerals to the Crown, but King obtained a certificate of title without a mineral reservation.

In 1947, the registrar corrected the Liebing and King titles by adding the notation "also reserving thereout all other Mines and Minerals." In the following year, the registrar issued a new title to HCL; in 1952, the registrar issued a new title to the present holders, the applicants, all as successors in title (apparently as volunteers) to HCL. Although King's solicitors questioned the cancellation of his title in 1951, no further action was taken until the registrar filed a registrar's caveat in 1977. This application was commenced many years later by the Liebing interests, presumably seeking to have the registrar's caveat expunged from the title.[180]

The decision of the Alberta Court of Appeal in *Krautt* v. *Paine*[181] seems to be on all fours and, if applied, would give the mines and minerals to King on the basis that King purchased the minerals on the faith of the certificate of title and also on the further and related basis that the registrar had no power to correct the error once King was on title. However, Rawlins J. distinguished *Krautt* on the basis that King had commenced his action out of time.[182]

After examining the pleadings, Rawlins J. decided that the action before the court (commenced by the Liebing interests) was an action for the possession of land and not an action seeking a declaration of title to land. The court further ruled that time began

177 *Ibid.* at para. 59. It is not clear why the challenge provision of the operating procedure is taken to strengthen the main conclusion except insofar as it allows Kaiser to bid in the interest and not just to veto another party. However, these are clearly separate rights in the agreement and the challenge provision can be triggered at different times.

178 (26 January 1999), Calgary 9701-06096 (Alta. Q.B.).

179 R.S.A. 1942, c. 162.

180 Presumably the application was brought under s. 144 of the *Land Titles Act*, *supra* note 165.

181 [1980] 6 W.W.R. 717 (Alta. C.A.) [hereinafter *Krautt*]. For the subsequent action by the losing party against the registrar see *McWhorter* v. *Alberta (Registrar of the North Alberta Land Registration District)* (1988), 57 Alta. L.R. (2d) 118 (Q.B.), aff'd (1989), 67 Alta. L.R. (2d) 71, leave to appeal to S.C.C. refused (1989), 100 A.R. 395 [hereinafter *McWhorter*].

182 *Supra* note 178 at para. 10.

to run in 1951 when King became aware that his title had been corrected by the registrar. In the alternative, Rawlins J. went on to find that even if the registrar's caveat revived the King title, King was out of time by 1987.

The distinction between the two methods of proceeding, if indeed there is a real distinction, was first alluded to by Rand J. in *Turta* v. *CPR*.[183] CPR argued that the Turta interests could not bring their action since they had lost their title as a result of unauthorized corrections made by the registrar in 1943. Rand J. disagreed.

> On the view which I have taken that the petroleum rights were acquired by Turta and the CPR deprived of them, the possession, in the absence of physical workings and insofar as such incorporeal rights can be the subject of possession, must be taken to be an incident of ownership. In the circumstances there has been no legal or physical disturbance of that possession; at the most certain entries have been made on the certificate claiming rights which do not exist. The action is not, then, one to recover the land but to have those entries expunged and for a declaration of the plaintiff's interest. Since there has been no trespass and since the steps taken have, at the most, raised only a cloud upon the title, the question is whether an owner can be deprived of his land by the mere assertion on the register of unfounded claims. I know of no provision of law which by the passage of time, raises any right based on that mode of protesting an interest; it would be a novel form of prescription which the law does not recognize ... proceedings of this nature here can be taken at any time, and no question of limitation arises.[184]

Estey J., the only other justice to discuss the limitations issue, took the view that this was an action for the recovery of land that had been brought within time.[185]

Rawlins J.'s decision is probably inconsistent with earlier authority. Rawlins J. purports to distinguish *Krautt* on the basis that in that case, the applicant brought his action within the limitation period. But in *Krautt*, the registrar made the correction in 1946, yet the application to clear the title was not commenced until 1978.[186] Rawlins J. characterizes *Krautt* as an application brought within time because it was brought within ten years of the registrar's caveat. On Rawlins J.'s reasoning, this claim must involve the proposition that a registrar's caveat can revive a title that has been extinguished by prescription.[187] The court offers no authority for this proposition; it conflicts with general authority that a caveat cannot create rights but can only protect existing rights. Thus, in *Krautt*, Laycraft J. refers to the registrar's caveat as protecting Krautt's entitlement.[188]

In finding that time began to run against the King interests from the time they first contested the change made by the registrar, Rawlins J. places great weight upon King's

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183 [1954] S.C.R. 427.

184 *Ibid.* at 456.

185 *Ibid.*

186 *McWhorter*, *supra* note 181 at 72.

187 Does it not also involve the proposition that any party that has an interest adverse to the claim of the current title holder has ten years (or the applicable limitation period under the new *Limitations Act*, S.A. 1996, c. L-15.1) from the filing of a registrar's caveat to commence their action?

188 *Supra* note 181 at 732, 734.

failure to pursue the issue once it was drawn to his attention and upon the fact that the Liebing interests had continued to pay the mineral taxes on the property. Yet other authority suggests that neither factor should be conclusive.[189] The real issue is whether the Liebing interests dealt with the property in an open, notorious, and exclusive manner by, for example, not just granting a mineral lease but by having the mineral lessee commence work on the lands. That issue was explicitly raised at trial in *Krautt*, but Steer J. dismissed the argument,[190] and it did not appear again in the court of appeal.

In sum, the cases suggest that time does not begin to run just because of a registrar's correction of title, even if brought to the attention of the title holder. There was no real evidence in this case of other acts of adverse possession, and the Liebings took their interest as mere volunteers. The registrar's error in 1947 conferred upon them a benefit to which they were not entitled.[191] It was the Liebing interests who were out of time. They should have commenced an action against the registrar for compensation from the assurance fund within six years of the original deprivation.[192]

The case is on appeal and has been set down to be heard in October 1999.

H. *CARRUTHERS* v. *TIOGA HOLDINGS*[193]

Carruthers ("C") and Hyland ("H") sold a parcel of land to Z. In the contract of sale, C and H reserved an option to purchase a parcel of the land for a nominal sum. The option clause required Z to support C and H's application for subdivision approval. C and H filed a caveat that referred specifically to the option by paragraph number but not to the accompanying covenants. Tioga Holdings Ltd. ("T") was the successor in title to Z and took with notice of the terms of the agreement but argued that the covenants to co-operate with the subdivision application were unenforceable on the grounds that they were not protected by the caveat and also that they were positive covenants that could not be made to run with the land.

Both the master and the chambers judge found in favour of T on the covenant point, but the Court of Appeal, in a memorandum of judgment, found for C and H on both grounds. Consistent with other cases[194] in which the court has distinguished *Calford Properties* v. *Zellers*[195] and *Ruptash* v. *Zawick*,[196] the court held that the caveat was

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189 In *Krautt*, it is clear that Krautt knew or should have known that the registrar was denying him his mineral interest since the registrar called Krautt's duplicate certificate of title in for correction and provided reasons for doing so (at 720) in 1946. Other cases downplay the significance of payment of taxes and suggest that even a grant of an oil and gas lease will not cause time to run: see *Re Panther Resources* (1984), 29 Alta. L.R. (2d) 220 at 231-34 (Q.B.).

190 [1979] 3 W.W.R. 481 at 507.

191 The characterization is Kerans J.'s: see *McWhorter*, *supra* note 181 at 73.

192 *Ibid.*

193 (2 March 1999), Calgary 98-17670 (Alta. C.A.), rev'g [1997] 9 W.W.R. 496 (Alta. Q.B.).

194 *Canadian Superior Oil* v. *World Wide Oil and Gas* (1990), 65 D.L.R. (4th) 417 (Alta. C.A.), leave to appeal to S.C.C. refused [1990] A.W.L.D. 511.

195 [1972] 5 W.W.R. 714 (Alta. S.C. (A.D.)).

196 [1956] S.C.R. 347.

adequate, even though it only referred to the right conferred by one paragraph of the agreement. The court offered several reasons for its conclusion. In particular, it noted that it could not "read the wording of this caveat as being exclusive and confined to one subparagraph." Of broader significance are the findings that subdivision approval is subsidiary conveyancing machinery and even had the covenant to support the subdivision approval not been expressed, the court would imply it anyway. The positive covenants were binding on T for somewhat similar reasons "given the plain Canadian law that the subdivision application is conveyancing machinery merely ancillary to the duty to convey...."

It is, of course, clear law that an option to purchase is an interest in land that will support a caveat and bind subsequent purchasers of the property.[197] It does not follow from this that all of the positive covenants associated with the option will necessarily bind, just as it does not follow that all promises contained within a lease will bind assignees of the lease and the reversion.[198] Much should therefore depend upon the characterization of the additional positive promises. Some analogies suggest themselves. In the law of landlord and tenant, the issue is whether the promise touches and concerns the subject matter of the demise.[199] In the law of rent charges, the issue is whether the covenant tends to support the charge.[200] However, beyond these contexts, the test should be an onerous one. It is one thing to say, as does the court of appeal in its examples, that the person bound by the option is obliged to recover the duplicate certificate of title from the safety deposit box and that a court official can sign the conveyance if the vendor refuses. These are obvious cases. However, if the obligations are more onerous in terms of time and expense, then the case is less clear.

This case has potential application to oil and gas agreements. Such agreements frequently create interests in land. This case offers some limited support for the idea that promises that are incidental to such interests will run with the interest and bind subsequent purchasers, even though those promises are positive in nature.

I. *KASHA* v. *BYE*[201]

The plaintiffs each held an undivided 5 percent interest as tenants in common in the mines and minerals in a quarter section. The defendants held an undivided 50 percent interest but as joint tenants amongst themselves. The plaintiffs applied for an order for the sale of the mines and minerals in the quarter section under s. 15 of the *LPA*.[202] The defendants argued that part 3 of the *LPA* did not apply to them, apparently on the basis that the plaintiffs could not seek a sale of the interest held by the defendants as joint tenants amongst themselves, or, alternatively, on the basis that the owner of an undivided interest in the fee simple of the mines and minerals estate was not a co-

197 *Frobisher Ltd.* v. *Canadian Pipelines and Petroleums*, [1960] S.C.R. 126.

198 *Rhone* v. *Stephens*, [1994] 2 All E.R. 65 (H.L.).

199 *Spencer's Case* (1583), 5 Co. Rep. 16a; *Law of Property Act*, R.S.A. 1980, c. L-8, s. 59.21 [hereinafter *LPA*].

200 R. Megarry and H.W.R. Wade, *The Law of Real Property*, 5th ed. (London: Stevens, 1984) at 768.

201 [1998] A.J. No. 697 (Q.B.), online: QL (AJ).

202 *Supra* note 199.

owner within the meaning of s. 14(a) of the *LPA* since an estate in fee simple is more than an interest in land.

Quinn J. held that part 3 of the *LPA* did apply. The term "interest in land" as used in s. 14(a) of the *LPA* includes a fee simple estate as well as lesser interests such as a *profit à prendre*. All that the plaintiffs needed to establish to bring themselves within the section was unity of possession and this they had done; they did not need to establish unity of title.

This decision is clearly correct.

IV. INDUSTRY AGREEMENTS

A. *HOME OIL* v. *NORTHRIDGE EXPLORATION*[203]

Northridge Exploration Ltd. ("NEL") proposed to sell its interests in certain properties and sent out right of first refusal ("ROFR") notices to three parties including Home Oil Co. ("H"). The notices were sent on NEL letterhead using an outdated address. The notices themselves specified the correct return address but asked ROFR parties to use a duplicate copy of the ROFR letter (using the outdated letterhead) to reply. A telephone inquiry initiated by NEL indicated that H would probably be exercising the ROFR. H purported to exercise the ROFR but sent the form to NEL's old office address by mail. The notice was not received by NEL at its current address until after closing. Some months earlier NEL had sent out a general change of address notice to all members of the oil and gas industry, including H. The participation agreements ("PAs") containing the ROFR prescribed a notice for a change of address. There was some evidence to the effect that an additional change of address notice was included within the ROFR package. On these facts had H properly exercised its ROFR?

Wilkins J. held that H had properly exercised its ROFR, and even if it were not in strict compliance with the terms of the ROFR, this was a case in which it was appropriate to relieve H from strict compliance.

On the balance of probabilities, NEL could not prove that an additional change of address form was included with the ROFR notice. It was doubtful if NEL's general change of address notice satisfied the requirements of the PAs but even if it did, NEL's subsequent use of letterhead indicating its old address should constitute a further change of address. Consequently, H did exercise its ROFR rights strictly in accordance with the PA. Even if this were not the case, it was appropriate to relieve against strict compliance, especially since NEL elected to close before the expiry of the ROFR period and notice of exercise was actually received by NEL within the ROFR period once account was taken of statutory holidays and the permissible mailing period prescribed by the PA. Taking into account all the facts, NEL had a duty to ascertain H's intentions prior to closing.

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203 [1998] A.J. No. 519 (Q.B.), online: QL (AJ).

B. *COACHLIGHT RESOURCES* V. *DUCE OIL*[204]

Coachlight Resources Ltd. ("CR") and Duce Oil Ltd. ("Duce") agreed to plug back and re-enter an existing vertical well and complete it as a horizontal producing well. CR, as operator under the 1981 Canadian Association of Petroleum Landmen ("CAPL") form, prepared the authority for expenditure ("AFE") which Duce executed. The operation ran into difficulties from the outset. The parties ultimately drilled three different legs before completing the well. CR also installed a screw pump and packers to deal with excessive water flow. The packers were only partially successful with the result that the well had a high oil-water ratio and triggered high battery processing costs. While the parties had a 65/35 interest in the well, the battery was owned 97 percent by CR.

Some of the difficulties encountered in the operation were due to poor procedures followed by the drilling contractor and for which the contractor acknowledged responsibility. Duce's allegations that other problems were the result of CR's negligence were all rejected by the trial judge.

Duce refused to pay for the cost overruns in the original AFE. Duce also argued that it was not responsible for the costs of installing packers or the screw pump and claimed that it should not be responsible for full battery costs. CR gave Duce a default notice under the CAPL agreement and subsequently commenced this action seeking an order requiring Duce to pay the balance of its share of costs. CR also sought a declaration that it held a builders' lien against Duce's interest in the property and assets located on the lands.

Pritchard J. found in favour of CR on all grounds. The court held that Duce, who was fully consulted all along, consented to the drilling of three different legs and to the installation of the packers. Duce was therefore liable for all costs notwithstanding the fact that the original AFE contemplated neither the installation of packers nor the drilling of multiple legs. Drilling of the second and third legs seems to have been justified on the basis that the first two legs deviated outside the target zone and were therefore not the type of well contemplated by the original AFE. The operation to install a screw pump stood on a different footing since this occurred after CR had served the default notice. Pritchard J. accepted Duce's proposition that a joint operator in default was not entitled to "any further information or privileges" (CAPL paragraph 505(b)(i)) and that therefore "CR was entitled to install the screw pump without consulting with its defaulting Joint-Operator who was also not entitled to approve the AFE for the ... operation."[205]

The 1981 CAPL form requires that where there is an AFE cost overrun of more than 10 percent, the operator shall "forthwith" advise the joint operators and submit a written supplementary AFE to them "for their approval." The court found that CR had satisfied both of these requirements. Although there was some delay in submitting the

204 [1999] S.J. No. 122 (Q.B.), online: QL (SJ).

205 *Ibid.* at para. 35.

supplementary AFE, this was explained by the fact that it was necessary for CR to negotiate with the drilling contractor to ascertain by how much its invoice should be reduced. In the circumstances, the supplementary AFE was issued as soon as was practical.[206] Furthermore, once issued, Duce was obliged to approve the supplementary AFE to the extent that it covered additional operations or cost overruns that the joint operator has already approved of orally in the actual course of the operation.

Finally, the court held that, in default of payment within the prescribed time, CR was entitled to file a builders' lien against Duce's interest in the property.

For a number of reasons, this decision represents a useful addition to the growing body of cases on the AFE. First, without discussing the conflict, Pritchard J. comes down firmly in favour[207] of Moshansky J.'s interpretation of the AFE provisions of the 1981 CAPL in *Morrison Petroleums* v. *Phoenix Canada Oil*,[208] rather than Sulatycky J.'s interpretation in *Novalta Resources* v. *Ortynsky Exploration*.[209] It will be recalled that Sulatycky J. took the view that the requirement of a supplementary AFE did not apply to a drilling AFE. Moshansky J. in *Morrison* rejected that position and also took the view that a supplementary AFE is mandatory and that it must indeed be served "forthwith" once the overruns become apparent. Pritchard J. affirms this view but at the same time takes a pragmatic approach in finding that the requirements of article 3 can be satisfied by oral approval followed up by written execution of the AFE. While pragmatic and attractive,[210] the holding is not completely consistent with the actual language of clause 301 which requires a "written supplementary authority."

Secondly, Pritchard J. has taken a very broad, and quite extraordinary, view of paragraph 505(b)(i). This paragraph allows the operator to "withhold from [a joint operator in default] any further information and privileges with respect to operations." Pritchard J. interprets this paragraph to deny the joint operator the right to receive an AFE and yet at the same time holds that the joint operator is on the hook for any operation conducted by the operator as if it were conducted for the joint account. This is remarkable and flies in the face of the careful drafting of article 3 of the CAPL which distinguishes between three types of operations for the joint account: (1) operations necessary and prudent the total estimated cost of which is no more than $25,000; (2) an expenditure or operation "necessary by reason of an event endangering life or property"; and (3) any other operation with the written consent of the joint

206 *Ibid.* at para. 33.

207 "This court entirely agrees with the interpretation of Clause 301 of CAPL 1981 as found in *Morrison*."

208 (1997), 198 A.R. 81 (Q.B.) [hereinafter *Morrison*].

209 (1994), 18 Alta. L.R. (3d) 4 (Q.B.).

210 It is attractive because it allows us to honour the policy principle that in a risky enterprise such as this, consent to the operation should be consent to the cost of completing the operation to the casing point election. A joint operator should not be able to go non-consent in the course of the operation. See *Renaissance Resources* v. *Metalore Resources*, [1984] 4 W.W.R. 430, [1985] 4 W.W.R. 673 (Alta. C.A.) [hereinafter *Renaissance Resources*].

operators. Clause 505 must be interpreted in this broader context which must also include the independent operations provisions of the agreement.

Thirdly, the decision draws attention to the possible use of the builders' lien remedy to expand the contractually based remedies already conferred by the CAPL, including the operator's lien. Unfortunately, Pritchard J. did not provide any guidance as to the application of the Saskatchewan legislation on this point. Presumably, the primary advantage from the operator's perspective in a situation such as this is that the builders' lien remedy will provide access to clear judicial procedures for the sale of joint operator's interest in the property.

Finally, presumably because Duce entirely failed to adduce satisfactory evidence of negligence, the court offers no additional guidance on what remains a troubling conflict between the duty of the operator to conduct all of its operations in a good and workmanlike manner and the liability and indemnity clauses of the CAPL form, which suggest that losses suffered due to the negligence of the operator are losses for the joint account.[211]

C. *KAISER FRANCIS OIL COMPANY OF CANADA* v. *BEARSPAW PETROLEUM*[212]

Under the original 1953 agreement, the predecessor in interest of Kaiser Francis Oil Co. ("Kaiser") was appointed as operator. A 1960 amendment to the original agreement appointed Medallion as the operator. Norcen Energy Resources Ltd. ("Norcen") was the successor in interest to Medallion. The amending agreement provided that, except in the case of the usual challenge procedure under the operating agreement, there should be no change of operatorship without the consent of the other party. In 1994, Norcen sold its 35 percent interest in the property to Bearspaw Petroleum Ltd. ("Bearspaw"). Kaiser consented to the sale but did not consent to the assignment of the operatorship. Kaiser did tolerate Bearspaw having a temporary period of *de facto* operatorship on behalf of and in the name of Norcen. Kaiser sought a declaration that it was entitled to operate the property.

Sullivan J. found in favour of Kaiser. He had little difficulty in concluding that Bearspaw had not succeeded to the operatorship, both because that right had never been assigned by Norcen (see discussion in section III.F, above), but also because the change required Kaiser's consent. As noted above, Kaiser had not given its consent either expressly or impliedly and neither was Kaiser estopped from asserting that it had not consented. Such co-operation with Bearspaw as Kaiser displayed in order to deal with a drainage problem was more in the nature of an indulgence than a waiver of right.

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211 CAPL form, Article IV, "Indemnity and Liability of Operator." On this point see *Morrison*, *supra* note 208, *Renaissance Resources*, *supra* note 210 and *Erehwon Exploration* v. *Northstar Energy* (1993), 15 Alta. L.R. (3d) 200 (Q.B.). See generally, C. Feasby, "Fiduciary Obligations and Exculpatory Clauses" (1998) 36 Alta. L. Rev. 923.

212 [1999] A.J. No. 153 (Q.B.), online: QL (AJ).

But if Bearspaw was not entitled to act as operator, was Bearspaw entitled to its declaration? This was a more difficult problem for the agreement did not expressly address the factual situation that had arisen. The court gave two reasons for affirming Kaiser's claim. The first reason, which is not very convincing, was that Kaiser had triggered the challenge provision of the agreement by asking Norcen to step down as operator and by garnering support from other joint operators for its candidature.[213] The second reason saw the court terminate the 1960 amending agreement and revive the original 1953 agreement. On a strict reading of the 1960 amendment, a party who assigns its interest in the property but fails to secure consent to an assignment of the operatorship must continue as operator.

Sullivan J. described this situation variously as "somewhat incongruous" and as a "nonsense." In light of that last characterization, it was but a short step to conclude that, while a contract is *prima facie* permanent and irrevocable, the agreement was terminable upon reasonable notice where the contractual operator had disposed of its interest. In support of this conclusion, the court referred to the recital to the amending agreement which acknowledged that the operator "is also an owner of an interest in the said properties." The 1960 agreement disposed of "the operating provision of the 1953 agreements becomes effective again," and thus Kaiser was entitled to succeed. Consequently, it was unnecessary to decide if Kaiser and other joint operators could remove Bearspaw as operator by the simple expedient of a majority vote.[214]

The conclusion seems sound. Certainly, it is easy to agree that Bearspaw had no right to assume the operatorship. The operatorship does not lie within the unilateral grant of the current operator. The 1990 CAPL standard form takes a similar position:

> 209 ASSIGNMENT OF OPERATORSHIP — In the event the Operator wishes its assignee to replace it as Operator after having disposed of all or a portion of its working interest in the joint lands and any production facilities to such assignees pursuant to Article XXIV, such assignee shall have the right to become operator if it is an Affiliate of the Operator, or, if it is not an Affiliate of the Operator, if the Parties agree that it shall become operator pursuant to Clause 206.[215]

Earlier iterations of the CAPL form[216] are not so explicit although presumably one can reach a similar conclusion by arguing that the provisions on the replacement of the operator constitute a complete code and that therefore the operator has no right of unilateral assignment.

Equally, it is hard to quarrel with the conclusion that Kaiser should be appointed as operator although it is clear that Sullivan J. struggled with the means by which to

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213 "In my view, this constitutes the requisite offer to operate on terms that Norcen is unwilling to meet, since it is Norcen's wish, for obvious reasons, to resign as operator. Accordingly, Kaiser is entitled to assume operatorship of the lands." *Ibid.* at para. 75.

214 *Ibid.* at para. 65.

215 See also clause 202, which provides that an operator shall be replaced immediately pursuant to clause 206 if "the Operator assigns or purports to assign its general powers and responsibilities of supervision and management as Operator hereunder."

216 See, *e.g.*, CAPL 1981, Article 2.

achieve this conclusion. The revival of the original 1953 agreement while convenient is not very intellectually satisfying. Under the CAPL forms the lacuna referred to by Sullivan J. would not exist since it would be possible for the other joint operators, were they so minded, to trigger the general replacement provision providing for replacement by affirmative vote of a majority of the joint operators.[217] Presumably .there was no similar clause here.

D. *KLEIMAN ENTERPRISES* V. *UNOCAL CANADA*[218]

The predecessor in title of Kleiman Enterprises Ltd. ("K") granted Imperial a lease in 1949 for a section of land. Under the terms of a 1951 farmout agreement, Wascana ("W") earned a sub-lease to part of the lands. The sub-lease incorporated the terms of the head lease, and under the farmout W covenanted to pay the head lessor's royalty as well as a gross overriding royalty to Imperial. W also indemnified Imperial for any losses that Imperial might suffer as a result of W's breach of this obligation. By a series of transactions, W's interest became vested in Unocal Canada Ltd. ("U") and then Primrose ("P"). Imperial's interest became vested in W.

K filed a statement of claim against, *inter alia,* U and P alleging that they were successors in interest of Imperial and that they had breached their obligations under the lease. K sought a declaration that U and P's interests under the lease had terminated.

U and P brought motions to strike and Gunn J. of the Saskatchewan Court of Queen's Bench granted the application. While acknowledging the general rule that the applicant on a motion to strike must accept the plaintiff's pleadings as true, he noted that this is qualified by a general exception that permits the court to examine any documents referred to in the statement of claim that are needed by the plaintiff to sustain its claim. In the present case that exception allowed the court to look at the farmout agreement, the sub-leases, and the chain of documents by which U and P acquired their interests.

Examination of those documents revealed that K could have no cause of action against U or P since there was neither privity of estate nor privity of contract between K and U or P. K had not alleged that the farmout agreement constituted an assignment. This was a clear case in which the statement of claim disclosed no reasonable cause of action and therefore should be struck. It was not appropriate to allow K to amend its pleadings to plead that U and P were unjustly enriched by failure to pay royalties in the proper amounts. A court should not allow an amendment that would be futile or an abuse of process. In this case there was no basis for arguing that either U or P had been enriched by K in the absence of privity, and if K had suffered a loss it had its remedy in the form of an action against W, the assignee of the original lease.

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217 CAPL 1990, para. 202(b).

218 (1998), 165 S.R. 85; [1998] S.J. No. 146 (Q.B.), online: QL (SJ).

E. *ROBERT LEMMONS AND ASSOCIATES* V. *GANNON BROS. ENERGY*[219]

The plaintiff sought various orders seeking to implement and enforce judgment in the main action[220] dealing with liability for the costs of a joint operation apparently conducted under CAPL 1981. Many of the issues related to the form of the accounting that was required. The trial judge ordered a full and complete accounting of the two wells, but it is not clear if this order was based upon the CAPL agreement and accounting procedure or based on the court's inherent jurisdiction. In the end, there was little to choose from since under the authority of both it was insufficient for Gannon Bros. Energy Ltd. to produce only a statement of revenues and expenses. It must provide "a justifying analysis of its expenditures, it must produce the documentation, including invoices and cheques, to discharge its responsibilities and it must bear the cost of providing the information in the first instance."[221]

V. CREDITORS' REMEDIES

In the bankruptcy and insolvency context, long-term natural gas sales contracts have provided the courts with a number of interesting issues for determination. In the cases discussed below, the plaintiffs asked the court to expand the normal legal meanings of various legal concepts or doctrines as they have typically been applied in bankruptcy and insolvency situations. In each case, the courts were unwilling to do so. One of the basic tenets of bankruptcy and insolvency law is that "like creditors" should all be treated equally. Since no one "like creditor" is likely to be satisfied in full for its claims, a decision which provides one creditor with an advantage over another is not in keeping with that basic tenet. For some individual creditors, the courts' refusal to adopt the positions advocated by these creditors means that it will continue to be difficult for a company to protect itself against loss in the event of the bankruptcy or insolvency of a debtor. However, for creditors as a whole, the courts' decisions in the following cases are to their advantage.

A. *LG&E NATURAL GAS* V. *ALBERTA POWER RESOURCES*[222]

This case involved an interesting attempt by a natural gas buyer to expand the scope of the meaning of "debt" for the purposes of paragraph 43(1)(a) of the *Bankruptcy and Insolvency Act*[223] to include a damage claim for anticipatory breach of contract.

In May 1997, Alberta Power Resources Inc. ("ARI"), a supplier of natural gas, advised LG&E Natural Gas Inc. ("LG&E") that it was ceasing operations and would no longer supply LG&E with the natural gas it was contractually obligated to sell and further, that it had only $80,000 in the company to satisfy any claims LG&E had

219 [1999] S.J. No. 43 (Q.B.), online: QL (SJ).
220 (1995), 130 Sask. R. 151 (Q.B.), aff'd [1996] S.J. No. 762 (C.A.), online: QL (SJ).
221 *Supra* note 219 at para. 37. One other issue is perhaps worthy of note. The court refused to split a lump sum order in accordance with the parties' participating interests, holding instead that the judgment was clear and final on this point and awarded a sum certain, *ibid.* at paras. 24-26.
222 [1997] A.J. No. 1013 (Q.B.), online: QL (AJ) [hereinafter *LG&E*].
223 R.S.C. 1985, c. B-3 [hereinafter *BIA*].

against it. LG&E's response was to attempt to petition ARI in bankruptcy and to obtain a receiving order, claiming that ARI was "indebted" to it for the cost of finding new gas sources arising out of ARI's anticipatory breach of the natural gas supply contracts. In order to make the petition, however, LG&E had to establish, pursuant to paragraph 43(1)(a) of the *BIA*, that ARI was "indebted" to it for at least $1,000.

In dismissing LG&E's petition, Fraser J. adopted the standard meaning of "debt" in law and was unwilling to expand this meaning for LG&E:

> A debt is a sum due by certain and express agreement; a specified sum of money owing to one person from another, including not only the obligation of a debtor to pay but the right of a creditor to receive and enforce payment.[224]

Citing relevant case law, Fraser J. noted that the cost of a replacement item purchased by a wronged party in anticipation of breach of a contract could only be qualified as damages.[225] Even though the sum was easily ascertainable, it was not a sum that ARI had agreed to pay, nor was it a sum that LG&E was entitled to receive and enforce as no judgment on the amount had been given or obtained.

An acceptance by the court of LG&E's attempt to have its damage claim for anticipatory breach of contract characterized as a "debt" would no doubt provide the holders of long-term future sales contracts with an alternative avenue for redress in circumstances where such damages (that is, the cost of finding alternate sources of supply) directly and naturally flow from the breach and are relatively easily ascertainable. But damages, unlike liquidated debts, are subject to other principles of law, such as the duty to mitigate losses and the right of set-off. If the court were to accept LG&E's position, petitions into bankruptcy would become less certain, swift, and definable (relatively speaking) and more protracted, costly and inefficient, contrary to the interests of creditors generally. Although LG&E was apparently the only outstanding creditor of ARI at the time and such considerations would not come into play in the circumstances of that case, the court was not willing to make an exception for LG&E and its petition was dismissed.

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224 Quoted by L.W. Holden & C.H. Morawtz in the 1997 *Annotated Bankruptcy and Insolvency Act*, looseleaf (Scarborough, Ont.: Carswell, 1992) at 346, citing *Re Central Capital Corp.* (1995), 29 C.B.R. (3d) 33 (Ont. Gen. Div.). *Ibid.* at para. 14, the court cited a passage from A.G. Guest, ed., *Chitty on Contracts — General Principles*, 27th ed. (London: Sweet & Maxwell, 1994) at 1201-202 to the effect that the distinction is important since the rules on damages (related, for example, to the duty to mitigate) do not apply to a claim for debt.

225 *Supra* note 222 at para. 16, citing *Citibank Canada* v. *Confederation Life Insurance* (1966), 42 C.B.R. (3d) 288 (Ont. Gen. Div.).

B. *COMPTON PETROLEUM* V. *ALBERTA POWER*[226]

NESI Energy Marketing Canada Ltd. ("NESI") entered into gas supply agreements with Alberta Power Limited ("Alberta Power") under which NESI agreed to supply gas to Alberta Power. Unbeknownst to Alberta Power, NESI was acting as the agent of Compton Petroleum Corp. ("Compton"). At the same time, NESI, as principal, had contracted for the sale and supply of gas with an affiliate of Alberta Power under which NESI was indebted to the affiliate. Alberta Power purported to set off the money that NESI owed the affiliate against money that Alberta Power owed to NESI. Compton sued Alberta Power for the amount it had set off.

Although the court agreed that if the debt arose prior to Alberta Power learning of the agency, Alberta Power would be entitled to set off monies owing to NESI if, in fact, it was entitled to the right to set off. But the court was not convinced that Alberta Power had that right. There was no right of set off under the terms of the agreement with NESI; therefore, Alberta Power had to establish that it was entitled to set off at law or equity.

Citing K.R. Palmer,[227] the court held that the following elements must be present to establish legal set-off:

> Liquidated debts — the claims between the two parties must be for liquidated amounts. Non-liquidated claims and non-money claims do not qualify.
>
> Mutuality — the cross claims must be between the same parties, in the same right.[228]

Although the court concluded that Alberta Power owed NESI a liquidated amount, it was unable to determine whether the money NESI owed to the Alberta Power affiliate was a liquidated debt, damages, or merely property in the form of gas. Therefore, the first element was not met. In order to establish the second element, Alberta Power would have to establish that the affiliate was acting as Alberta Power's agent in its dealings with NESI, or that in the circumstances the court could pierce the corporate veil. The court concluded that no such evidence had been presented. Alberta Power, therefore, had no basis for claiming a right to set off in law.

In order to establish a right to claim set-off in equity, the court cited the following elements of equitable set-off adopted by the Alberta court in *Royal Bank* v. *Wilton*:

> The five elements cited by the Supreme Court of Canada [in *Holt* v. *Telford*, [1987] 2 S.C.R. 193] were taken from the case of *Coba Industries Ltd.* v. *Millie's Holdings (Canada) Ltd.*, [1985] 6 W.W.R. 14 (B.C.C.A.). Specifically the five elements are as follows [p. 22]:

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226 [1999] A.J. No. 218 (Q.B.), online: QL (AJ).

227 *The Law of Set-Off in Canada* (Aurora, Ontario: Canada Law Book, 1993).

228 *Supra* note 226 at para. 27.

1) the party relying on the set-off must show some equitable ground for being protected against his adversary's demands...

2) The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed...

3) A cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross-claim...

4) The plaintiff's claim and the cross-claim need not arise out of the same contract...

5) Unliquidated claims are on the same footing as liquidated claims....[229]

On these elements, the court held that Alberta Power had not shown an equitable ground for being protected against Compton's claims. The relationship between Alberta Power and its affiliate was not clearly connected with Compton's claim. Consequently, Alberta Power was not entitled to equitable set-off.

C. *NESI ENERGY MARKETING CANADA (TRUSTEE OF)* v. *NGL SUPPLY (GAS)*[230]

In December of 1996, NESI, a natural gas marketing company on both the purchase and supply side, was petitioned into bankruptcy. Several of its clients held both purchase and supply contracts with NESI under the terms of a "Master Agreement," although in each case, the Master Agreement stipulated that each contract for the sale or supply of natural gas was to be treated as an independent contract. Three clients of NESI, NGL Supply (Gas) Co. ("NGL"), CoWest Energy Ltd. ("CoWest"), and Direct Energy Marketing Ltd. ("DEML"), each of whom purchased and sold natural gas to NESI under their respective Master Agreements, submitted claims to NESI's trustee in bankruptcy. The trustee disputed the claims, alleging they were overstated and did not take into account any benefits the three companies had received as a result of NESI's breach of their agreements. Between the time that the Master Agreements were negotiated and NESI's bankruptcy, the price of natural gas had increased. As a result of the increase in price of natural gas, the companies' costs of replacing NESI's supply was considerable. These were the costs submitted to the trustee. However, as suppliers of NESI, the companies received considerably more for the natural gas they sold on the market than they would have received had they been contractually bound to sell the natural gas to NESI. These benefits were not, however, netted out of the losses the three companies submitted to the trustee. The companies' position was that the benefits they received under their supply contracts were independent of the buy-side contracts and were not relevant to the losses they suffered.

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229 *Supra* note 226 at para. 31, citing *Royal Bank* v. *Wilton* (1995), 28 Alta. L.R. (3d) 1 at 13.

230 [1999] A.J. No. 116 (Q.B.), online: QL (AJ).

The issue for the court was whether it could disregard the fact that the supply-side and buy-side contracts were expressly stated to be independent contracts given that the companies's losses and benefits flowed from the same breach (*i.e.* the bankruptcy of NESI). The court rejected the trustee's arguments that the doctrine of set-off could be applied, holding that there was no cross-claim of debts. NESI had no claim against any of the three companies from which it could set off the losses the companies suffered. Instead, the court held that it could consider these benefits either under the terms of the Master Agreement, in the case of NGL and CoWest, which appeared to the court to contemplate this situation, or under the principle of mitigation of losses and its corollary, loss avoidance, in the case of each of the parties.

Section 10 of the NGL and CoWest Master Agreements provided a formula for the wronged party to calculate its "Liquidated Damages" resulting from the termination of "each transaction entered into pursuant to the Agreement." The formula required the wronged party to include in its calculations any costs and any benefits or gains it suffered or obtained as a result of the termination of the parties' obligations under such transactions.

Under the second basis, the court applied the principles of mitigation of damages, citing the following *dicta* of Haldane L.J. in *British Westinghouse Electric & Mfg.* v. *Underground Electric Railways Co. of London*:

> The fundamental basis [of damages for breach of contract] is ... compensation for pecuniary loss naturally flowing from the breach; but this first principle is qualified by a second, which imposes on a plaintiff the duty of taking all reasonable steps to mitigate the loss consequent on the breach, and debars him from claiming any part of the damage which is due to his neglect to take such steps....
>
> [T]his second principle does not impose on the plaintiff an obligation to take any steps which a reasonable and prudent man would not ordinarily take in the course of his business. But when in the course of his business he has taken action arising out of the transaction, which action has diminished his loss, the effect in actual diminution of the loss he has suffered may be taken into account even though there was no duty on him to act.[231]

Fraser J. noted that a fundamental principle of damages prescribes the recovery of "true loss only" — no more and no less — and referred to this as the "compensatory ideal." He held that so long as the benefits were not wholly independent and collateral to the losses, but arose as a result of a "connected chain of events," they were properly to be taken into consideration when assessing the claims of a wronged party. In this case, both the companies' losses and benefits arose out of the same event, the bankruptcy of NESI, and although each was an independent contract, all were nonetheless governed by the Master Agreement, involving the same parties and the

[231] [1912] A.C. 673 (H.L.) at 689. The court noted that Haldane L.J.'s exposition was applied by the Supreme Court of Canada in *Cockburn* v. *Trusts & Guarantee* (1917), 55 S.C.R. 264 and *Asamera Oil* v. *Sea Oil & General*, [1979] 1 S.C.R. 633. Also cited in support was H. McGregor, *McGregor on Damages*, 16th ed. (London: Sweet & Maxwell, 1997) at 186 and a number of other cases.

same commodity. As a result, the benefits received by the companies had to be deducted from the losses they suffered.

D. *CHEVRON CANADA RESOURCES* V. *NESI ENERGY MARKETING CANADA LTD.*[232]

Chevron Canada Resources ("Chevron") and NESI were parties to various natural gas purchase and supply transactions. The agreement between them provided that all outstanding transactions and the obligations to make payment in connection therewith under the agreement could be set off against each other. The only requirement was that notice of set-off had to be given on or by a specified date in the month. If such notice was not provided, then each was required to pay to the other the amount owed.

During the term of the agreement, the parties consistently utilized the set-off provisions and only one cheque was ever delivered monthly. However, in the particular month in question, Chevron did not receive the appropriate notice and a new administrative clerk at Chevron requisitioned a cheque for the full amount that Chevron owed to NESI. The cheque was delivered to NESI, who telephoned the next afternoon to advise that they had already prepared a cheque to send to Chevron based on the set-off procedure and would cancel that cheque and issue a new cheque to Chevron for the full amount owed. For some reason, NESI's cheque was not couriered to Chevron but was left for pickup at NESI's front desk. Chevron did not send anyone to pick up the cheque. The next day, NESI obtained an order under the *Companies Creditors Arrangement Act*,[233] which stipulated that NESI was to make no payment to any person unless authorized by the court. The cheque to Chevron was seized by NESI's trustee and Chevron sought to have the cheque released to it, advancing a number of arguments it hoped would establish that the creditor-debtor relationship between Chevron and NESI created a constructive or implied trust relationship, such that NESI was holding the cheque in trust for Chevron.

Each of the arguments offered by Chevron — unjust enrichment, mistake, and intent to create a trust — were rejected by the court. NESI was not unjustly enriched by keeping Chevron's cheque and, in fact, was entitled to do so under the terms of the contract as the set-off procedure had not been agreed to by the requisite date. Nor was there any mistake. Chevron has issued a cheque to NESI for the full amount owed by Chevron to NESI. Chevron had issued the cheque in accordance with the terms of the contract. Finally, the court found no evidence of intent to create a trust. The issuance of the cheque by Chevron to NESI was not sufficient evidence of the intent to create a trust. The court refused to take into consideration the fact that only one day following the delivery of Chevron's cheque to NESI, the parties agreed to the set-off procedure. Rather, the court held that until Chevron picked up the cheque *and cashed it*, NESI and Chevron were in a debtor-creditor relationship and the *CCAA* order was applicable.

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[232] [1998] A.J. No. 679 (Q.B.), online: QL (AJ).

[233] R.S.C. 1985, C-36 [hereinafter *CCAA*].

E. *ASHLAND SCURLOCK PERMIAN CANADA* v. *NESI ENERGY MARKETING CANADA LTD. (TRUSTEE OF)*[234]

This case involved claims by four parties against NESI's trustee in bankruptcy, who disputed a portion of the claims they made against NESI in accordance with the express terms of their contracts. The trustee asserted that a portion of the claims were sums in the nature of a "penalty" and were therefore unenforceable. The disputed portion of the claims fell under the following clause (or a variation of it), specifically, subclause (iv):

> Liability for Non-Performance
>
> (b) If Seller fails to perform its obligations to sell and deliver gas ... then Seller shall pay to Buyer:
>
> (i) the positive difference between the reasonable cost of any replacement supply of gas obtained by Buyer and the cost of gas under the Nomination Confirmation;
>
> (ii) the incremental transportation costs incurred by Buyer for the replacement supply of gas;
>
> (iii) any transportation penalties incurred by Buyer as a result of Seller's failure to deliver; and
>
> (iv) *[$0.05] per GJ of gas that Seller failed to deliver.*[235] [emphasis added]

The court reviewed a number of authorities on whether a provision is a penalty or a liquidated damages provision, applying the following considerations:

(1) the essence of liquidated damages is a genuine covenanted pre-estimate of damages;

(2) the time for determining whether a provision is penal or liquidated is at the time of the breach;

(3) it will be held to be a penalty if the sum is extravagant and unconscionable in amount in comparison to the greatest "usual" loss which be proved. If a sum exceeds foreseeable damages in all cases but an unusual one, the sum will be a penal one, even if the "unusual" case occurs;

(4) to be a liquidated claim, the default complained of and the loss must be related; and

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234 [1998] A.J. No. 678 (Q.B.), online: QL (AJ).

235 Three of the companies, PanEnergy Marketing Limited Partnership ("PanEnergy"), Enershare Energy Purchasing Services Limited ("Enershare"), and Vermilion Gas Marketing Inc. ("Vermilion") stipulated for $0.05, Ashland Scurlock Permian Canada Ltd. ("Ashland") stipulated for $0.25, and ATCO Services Ltd. ("ATCO") stipulated for $1.00.

(5) if the determination of the sum fixed or based on a formula that, in either case, does not take into consideration whether the contract, at the time of breach, had been substantially performed, or performance had only just begun, it will more likely be construed as a penalty.[236]

While the court noted that in each case the sum stipulated took into account prior performance (that is, the more gas actually delivered under the agreement previously, the less the damages would be), the amounts stipulated for by Ashland ($0.25) and ATCO ($1.00) were in the nature of a penalty. Ashland's claim under subsection (iv), for example, represented 156 percent of its unliquidated claim under subsections (i) to (iii). ATCO claimed its assessment of loss was based upon the gas market ceasing which, to the court, was clearly not a proper foreseeable claim and, as such, would be unconscionable to enforce.

No doubt, one of the purposes of these types of clauses is to make it more expensive for a seller to breach the contract so that if there is a shortage of supply, the seller will choose to honour the agreement that has the most severe penalties. If, however, the issue is not shortage of supply but bankruptcy and insolvency, the more severe and onerous this type of provision, the less likely it will be enforced.

VI. FIDUCIARY OBLIGATIONS

A. *COACHLIGHT RESOURCES* V. *DUCE OIL*[237]

There was a small fiduciary issue in this case. The facts are discussed in greater detail in section IV.B., above. Although the case is primarily concerned with AFE issues, Duce also argued that CR breached its fiduciary duty to Duce by continuing to operate the well even though it was a marginal producer. The argument was premised on the proposition that continued production was in CR's interests, but presumably not Duce's interests, because CR would collect battery fees based upon its much larger ownership interest in the battery. The court summarily rejected this argument noting that by continuing to produce, CR was preserving the underlying lease for the benefit of both parties.[238]

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236 The court cited: *Dunlop Pneumatic Tyre* v. *New Garage and Motor*, [1915] A.C. 79 (H.L.) [hereinafter *Dunlop*]; *H.F. Clarke* v. *Thermidaire*, [1976] 1 S.C.R. 319, which held that the principles in *Dunlop* were not to be taken as rigid rules, but guidelines only; *Dial Mortgage* v. *Baines* (1980), 15 Alta. L.R. (2d) 211 (Q.B.); *Fern Investments* v. *Golden Nugget Restaurant*, (1994), 19 Alta. L.R. (3d) 442 (C.A.), which cited *Stockloser* v. *Johnson*, [1954] 1 Q.B. 476 (C.A.) for the proposition that a penalty clause should be determined at the time of the breach (contrary to what was held in *Dunlop*); and *Elsley* v. *J.G. Collins Insurance Agencies*, [1978] 2 S.C.R. 916 among others.

237 *Supra* note 204.

238 *Ibid.* at paras. 44-45.

B. *TAYLOR* V. *SCURRY RAINBOW (SASK.)*[239]

The main facts are outlined in section III.B., above. In *Taylor*, Tarragon argued that by acquiring a top-lease to the property and then seeking to lapse the top-lease on perpetuities grounds, Maxx had breached a duty of confidentiality and a fiduciary duty that it owed to Tarragon. To understand the argument, a few more facts are needed in addition to those presented above in the context of the perpetuities issue.

In 1993, Maxx expressed an interest in acquiring the Taylor lands. Accordingly, Tarragon prepared a farmout agreement, and Maxx's lawyer attended at Tarragon's office to review the documentation. A month later, and after Maxx had top-leased the lands, Maxx advised Tarragon that it would not be proceeding with the farmout because of a perpetuities problem with Tarragon's title.[240] At all relevant times, the form of the Freeholders lease was on file with the Corporations Branch of Saskatchewan Justice, and the Freeholders caveat "largely" set out clauses 1 and 2 of the Freeholders lease.[241]

Under these circumstances, Gerein J. concluded that Maxx's conduct fulfilled the three elements required for establishing a breach of confidence as laid down by Sopinka and La Forest JJ. in *LAC Minerals* v. *International Corona Resources*.[242] Thus, Gerein J. held that: (1) the information conveyed was confidential; (2) the information was communicated in confidence in the course of joint venture or farmout negotiations; and (3) the information was given to Maxx to allow it to complete its due diligence title investigations, and it was misused by Maxx for its own account.

Gerein J. invited further argument on an appropriate remedy, observing that the usual remedy would be to restore the injured party either through a constructive trust or an accounting. Gerein J. also noted that he expected to receive further argument as to the scope of the constructive trust. Should it be confined to the interest that Tarragon would have had if the farmout had proceeded, presumably a 50 percent interest plus a well or some similar arrangement, or should it be the entire lease?

Although Gerein J. speaks somewhat loosely at times of a breach of trust,[243] it seems apparent that he did not deal with Tarragon's second argument of a breach of a fiduciary duty. This is a little unfortunate since, while Maxx no doubt acted in an underhanded way, it seems hard to square the conclusion of breach of a duty of confidence with the public knowledge of the document. However, if one could establish a fiduciary duty, the acquisition of a competing title is surely a breach of the fiduciary's undivided duty of loyalty. There might be public knowledge of the contents of the agreement, but, as a fiduciary, Maxx might be the one person in the world who could not take advantage of Tarragon's vulnerability. Could Maxx be a fiduciary in light of

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239 *Supra* note 113.
240 *Ibid.* at paras. 14-17.
241 *Supra* note 113 at para. 63.
242 [1989] 2 S.C.R. 574 at 608 (per Sopinka J.), 636 (per La Forest J.) [hereinafter *LAC*].
243 *Supra* note 113 at para. 66.

the majority decision in *LAC*? Clearly one would need more facts, but in this case negotiations were at a more advanced stage than those in *LAC*, and Maxx obtained the documentation purely for the purposes of checking title. That said, given the way the case is argued, one assumes that there was no express confidentiality agreement binding the parties, and it is clear that Sopinka J. considered that to be an important issue in deciding for the majority in *LAC*. In that decision it will be recalled that Sopinka J., for the majority, held that there could be no fiduciary relationship between the parties since Corona was not vulnerable. Corona could have protected itself by negotiating a confidentiality agreement.[244]

C. *CINABAR ENTERPRISE* V. *RICHLAND PETROLEUM*[245]

Cinabar Enterprise Ltd. ("Cinabar") was peddling some properties, including leases on sections 15 and 21. The leases were for ten-year primary terms and continued thereafter by production or deemed production. A well would be a deemed producer if non-production was "a result of a lack of or an intermittent or uneconomical or unprofitable market or any cause whatsoever beyond the Lessee's reasonable control." A publicly available plat for the area showed two wells on section 21: one labelled "abandoned gas well" and the other labelled "dry and abandoned." There was a gas well on section 15, and this was labelled "gas well." In fact, the section 15 well had long since been shut in and suspended, and the formerly producing well on section 21 was a poor producer that had ultimately been abandoned because of a casing leak that discharged gas from the surface casing vent.[246]

Richland Petroleum Corp. ("Richland") entered into negotiations for the purchase of the Cinabar properties and, in the course of doing so, had the opportunity to review the Cinabar files. The negotiations were unsuccessful. Sometime later, Richland top-leased the properties and gained good title when Cinabar's caveats were discharged by the registrar. Cinabar had failed to take action to maintain the caveats after having been served with a notice to do so. Cinabar then alleged that Richland had used confidential information to acquire the properties and that it therefore held them on trust for Cinabar. Romaine J. held that the information imparted to Richland by Cinabar did not have the necessary quality of confidentiality. Information as to the status of the wells was available from both the conservation board and vendors such as the supplier of the plat. Furthermore, there was little indication that Cinabar viewed any information that may have been imparted to Richland, either as to the status of the wells or as to its own plans, as confidential in nature.

Thus, in *Taylor* a public source of information was sufficient to deprive the information of the quality of confidentiality while in *Cinabar* it was not. The cases may be irreconcilable, but the difference may be that in *Cinabar* there was evidence that

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244 *Supra* note 242 at 607 (per Sopinka J.).

245 (1998), 225 A.R. 161, [1998] A.J. No. 891 (Q.B.), online: QL (AJ) [hereinafter *Cinabar*].

246 The court did not have to decide whether a well abandoned for environmental reasons rather than for its inability to produce could still be deemed to be a producing well upon tender of appropriate shut-in payments.

Richland had the publicly available information before attending the show and tell, while Gerein J.'s judgment in *Taylor* says nothing of Maxx's prior knowledge as to the contents of the documents on title except to state that Maxx had made unsuccessful attempts to obtain copies of the Freeholders lease.[247]

D. *DURISH* V. *WHITE RESOURCE MANAGEMENT*[248]

The facts of *Durish* are reviewed in section III.D., above. Durish assigned his farmout agreement with White to Lobell. Only after the transfer did Durish become aware of the title problems and set out to acquire the Pawnee/Haida lease and the Vold reversionary interest.[249] The evidence showed that Durish acquired the interests to protect Lobell's investment but that Durish never offered Lobell the opportunity to acquire the lease. The evidence also showed that there was limited, if any, disclosure of Durish's actions to his fellow directors of Lobell and, to the extent that there was disclosure to other directors, "their understanding was that all was done to protect Lobell and guarantee Lobell's title to the working interest. They never consented to Durish using his interest in a way that would be adverse to Lobell."[250]

Those facts were sufficient to establish liability. As a director of Lobell, Durish owed Lobell the utmost duty of loyalty. By taking a corporate opportunity that rightly belonged to Lobell, Durish breached that duty. It did not matter that at the time Lobell suffered no loss, Durish had a duty "to urge the corporation to purchase the lease when he learned that the Haida lease could have had an adverse impact on Lobell's interest."[251] Even if mere acquisition were not a breach, by prosecuting his claim against WRM, Lobell's successor in title, Durish was certainly in breach.

There appear to be two methods of reaching this last part of the conclusion. The first is to say that WRM must be the successor in interest to whatever claim Lobell might have had against Durish. Mason J. seems to have used this argument for two purposes. First, he used the argument to decide that WRM had standing to raise the issue. WRM was not a mere busybody; it had a contractual interest in the matter. Under the terms of its agreement with Lobell, it purchased Lobell's "[r]ight, title, estate and interest of any nature and kind" in the property. By that agreement:

> Lobell assigned to WRM the working interest rights it owned under the Vold lease.... It also assigned its beneficial interest to WRM which had to be claimed by way of legal action. The right of action to realize the beneficial title was therefore incidental to the rights to the working interest which was being transferred.[252]

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[247] *Supra* note 113 at para. 64.
[248] *Supra* note 148 at paras. 7-25.
[249] *Ibid.* at para. 131.
[250] *Ibid.* at para. 116.
[251] *Ibid.* at para. 133.
[252] *Ibid.* at para. 106.

The point seems to be that, even though the Pawnee/Haida lease was not included in the Lobell-WRM conveyance, any claim that Lobell might make to trump the priority of the Pawnee/Haida lease must also have passed to WRM.

Secondly, Mason J. also used the argument to shore up WRM's entitlement to benefit from the constructive trust that Mason J. imposed. If Durish was able to keep the proceeds of production by virtue of the Pawnee/Haida lease, he would be unjustly enriched:

> Correspondingly, Lobell and subsequently WRM as Lobell's lawful assignee, has been deprived of the profits of the stolen opportunity by reason of Durish's breach of his fiduciary duty as Lobell's director. WRM has a legitimate need for seeking the remedy of constructive trust, because although Durish has legal title to the proceeds of the well, WRM is the beneficial and rightful owner of the proceeds.[253]

The second method of argumentation reaches the same conclusion a little more indirectly.

> By asserting the claim against WRM, which is an assignee of Lobell, Durish has placed Lobell in a situation of potential liability for breach of contract, which is obviously not in its best interests. This is clearly a breach of his fiduciary duty to the corporation.[254]

The point seems to be that, notwithstanding the fact that the agreement pursuant to which Lobell agreed to convey title did not contain a warranty as to title, Lobell might still be in breach of some of its representations in the event that Durish's claim, based upon the Pawnee/Haida lease, were to succeed.[255]

In the result, therefore, Mason J. found that Durish was a constructive trustee of any profits accruing under the Pawnee/Haida lease. Lobell was the original beneficiary of this trust, but its beneficial interest had been transferred to WRM, and WRM was therefore entitled to the profits.[256]

253 *Ibid.* at para. 138.

254 *Ibid.* at para. 136.

255 The representations are reproduced at *ibid.* at para. 153 and included a representation that, to the best of the vendor's knowledge, information, and belief there are no charges, claims, or actions in existence, contemplated, or threatened against or with respect to the said properties or the interest of the vendor therein.

256 The subject matter of the trust seems to be the profits and not the lease itself. It is not clear why this is so unless it is simply that the lease had expired (see the companion case *White Resource Management* v. *Durish* (1988), 63 Alta. L.R. (2d) 265 (C.A.)) or because there was a concern for other contingent liabilities (clean-up, for example). It is hard to see how WRM could avoid these anyway, but surely it would be inequitable to allow WRM to cherry-pick; it would also need to take the accompanying burdens. See *LAC*, *supra* note 242, and especially the judgments at trial (1986), 53 O.R. (2d) 737 and in the Ontario Court of Appeal (1987), 44 D.L.R. (4th) 492, dealing with Corona's obligation to compensate LAC for improvements to the Williams property.

E. *TERRA ENERGY* V. *KILBORN ENGINEERING ALBERTA*[257]

The respondent, Kilborn Engineering Alberta Ltd. ("Kilborn"), was a professional engineering firm that had been engaged by the applicant, Terra Energy Ltd. ("Terra"), to provide professional engineering services for the purposes of assessing certain technology for extracting bitumen from oil sands (known as the solvent extraction spherical agglomeration process or the "SESA process") that Terra had under commercial licence. At the time, Kilborn was not engaged in developing any competing technology; however, it was in the business of developing technology for its own account and, during its work for Terra, William Strand, a senior engineer at Kilborn, conceived of a new and different technology for the extraction of bitumen from oil sands. The idea was presented to Kilborn, and the company resolved to develop and promote the competing technology.

At trial, Terra argued that Kilborn had breached its fiduciary duties to Terra by failing to disclose Kilborn's conflicting activities and that Kilborn was in breach of a duty of loyalty, good faith, and avoidance of conflict of interest pursuant to the professional engineers' industry code of ethics (the "Code of Ethics") by failing to disclose the existence of the conflict. The trial judge found, and Terra did not dispute, that Kilborn did not use any confidential information belonging to Terra in developing the competing technology. The trial judge dismissed Terra's claim that Kilborn had a fiduciary duty to it at law or under the Code of Ethics but concluded that Kilborn had breached its duties of loyalty and good faith to Terra by failing to disclose the fact, when it occurred, that Kilborn was developing the competing technology.

The Alberta Court of Appeal agreed that Kilborn did not owe any fiduciary obligations to Terra. Relying on the Supreme Court of Canada's earlier decision in *Hodgkinson* v. *Simms*[258] and Wilson J.'s dissenting opinion in *Frame* v. *Smith*,[259] the court noted that Kilborn's role was not an advisory one. Kilborn did not have the requisite discretion to affect the interests of Terra, nor was Terra vulnerable to Kilborn. Kilborn's role was merely to perform work specified by Terra in order to confirm information that Terra already had. In short, there was nothing in the relationship between the parties to warrant a finding that Kilborn stood in a fiduciary relationship to Terra.[260]

Terra attempted to argue that the fiduciary relationship arose out of Kilborn's obligations under the Code of Ethics. Again, citing *Hodgkinson*,[261] the court noted that the Code of Ethics could not impose fiduciary obligations on a professional engineer to the extent that such fiduciary obligations did not already exist.

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257 [1999] A.J. No. 221 (C.A.), online: QL (AJ).

258 (1994), 117 D.L.R. (4th) 161 (S.C.C.) [hereinafter *Hodgkinson*].

259 (1987), 42 D.L.R. (4th) 81 (S.C.C.) [hereinafter *Frame*].

260 *Supra* note 257 at paras. 36-37.

261 *Ibid.* at para. 40. See also *Hodgkinson*, *supra* note 258 at 187.

While the finding that Kilborn did not owe Terra any fiduciary obligations was fairly straightforward, the more interesting question in the case was whether Kilborn owed a duty of loyalty and good faith to Terra. The trial court held that the Code of Ethics formed part of Terra's and Kilborn's contractual relationship, and that therefore Kilborn owed and had breached such duties to Terra. The Court of Appeal disagreed, concluding that although Kilborn had an obligation to disclose its competing activities to Terra pursuant to the Code of Ethics, the Code of Ethics did not form part of the Kilborn's contractual obligations to Terra:

> Self-governing professions are customarily required by statute to formulate and administer rules holding their members to certain standards of conduct and providing for punishment for failure to meet those standards. Such rules are for the protection of the public in a general sense; they ensure that the public will have confidence in the competence and integrity of the profession. Professional conduct rules such as the Code of Ethics, are not designed or intended to serve as the basis for civil proceedings against members of the profession who may offend a provision of the conduct rules in the course of performing a professional service. There are other effective means open to clients for holding professionals to account for their conduct.
>
> Finally, it is well established that a breach of a statute or regulation does not, in itself, create a civil cause of action.[262]

The court's latter comment on this point is confusing since the Code of Ethics was not a statute or regulation. Perhaps what the court was trying to say was that although certain types of behaviour can give rise to a cause of action in the courts, such causes of action exist in law independently from the Code of Ethics. If there is no independent cause of action, a provision found in the Code of Ethics will not create one. In the present case there were no allegations that Kilborn was negligent in the performance of its duties or that it misappropriated confidential information. There was, therefore, no civil cause of action against Kilborn that arose.

In order to found the duty of good faith and loyalty, the Court of Appeal looked solely to the Code of Ethics without looking at the new and evolving doctrine of good faith that is emerging from the cases as an independent basis for founding a cause of action.[263]

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262 *Ibid.* at para. 59, 63, citing *R.* v. *Saskatchewan Wheat Pool*, [1983] 3 W.W.R. 97 (S.C.C.) and *Frame*, *supra* note 259.

263 For a discussion of this emerging doctrine, see S. O'Byrne, *Good Faith in Contractual Performance: Recent Developments* (1995) 74 Can. Bar. Rev. 79; S. O'Byrne, *Liability for Non-Disclosure in Contracts* (1998) 30 Can. Bar. Rev. 239. Several cases which have started to outline this doctrine include: *Bank of Nova Scotia* v. *Dunphy Leasing Enterprises* (1992), 120 A.R. 241 (Q.B.); *Mesa Operating Limited Partnership* v. *Amoco Canada Resources* (1994), 149 A.R. 187 (C.A.); *Novalta Resources* v. *Ortynsky Exploration* (1994), 151 A.R. 241 (Q.B.); *Consolidated Oil and Gas* v. *Suncor* (1993), 140 A.R. 188 (Q.B.); *Erehwon Exploration* v. *Northstar Energy* (1994), 147 A.R. 1 (Q.B.); and *Gateway Realty* v. *Arton Holdings* (1991), 106 N.S.R. (2d) 180 (S.C.), aff'd 112 N.S.R. (2d) 180 (C.A.), among others. Several principles can be derived from these cases, although, as an emerging doctrine, the importance or significance of any one of them has yet to be determined:

intention and bad faith conduct are not elements of a breach of good faith;

While it is not clear from the facts in this case that the conduct of Kilborn could support a cause of action for breach of duty of good faith, it would have been useful for the Court of Appeal to have discussed the doctrine in order to help "flesh out" the scope of the duty between commercial parties.

VII. SURFACE RIGHTS

A. *CANADIAN WESTERN NATURAL GAS* v. *EMPIRE TRUCKING PARTS (1985)*[264]

This case deals with the rights held by the plaintiff, Canadian Western Natural Gas Co. ("CWNG"), under a 1958 easement agreement (the "Right of Way") giving it an exclusive easement over the land for the purposes of laying, maintaining, and operating its pipeline "for as long as the Grantee shall require." Under the terms of the Right of Way, the grantor covenanted and agreed, among other things, that he would not erect any buildings or structures on the strip of land without the consent of the grantee, and that the grantee would not be hindered by the grantor or anyone claiming by, through, or under him. The lands over which the Right of Way was situate were sold in 1971 to the defendants, Empire Trucking Parts (1985) Ltd. ("Empire"), which operated a truck parts and wrecking business. Although the Right of Way was properly registered against title, soon after acquiring the property, Empire placed an immobile trailer over the Right of Way and thereafter, continued to use the Right of Way as a storage area for damaged trucks (many of which were mechanically immobile) and used truck parts. Although the problem had been ongoing since that time, CWNG had never taken any court proceedings to defend its rights under the Right of Way. It had, however, written four letters in the twenty-six years prior to trial[265] requesting that Empire remove its property from the strip of land. Empire refused to do so and, in 1998, CWNG sought a declaration of a valid easement for the Right of Way and injunctive relief to cause Empire to honour the terms of the Right of Way.

- the doctrine does not spring solely from a fiduciary or quasi-fiduciary relationship but arises out of the terms of the contract and the reasonable expectations of the parties (objectively assessed) about the meaning and terms and about performance standards;
- good faith encompasses the notion that parties will deal fairly, honestly, and reasonably with one another;
- good faith may give rise to a secondary obligation of disclosure in "contracts of enterprise" - the duty not to withhold critical information which distorts the other party's evaluation of the contract's risks and benefits;
- a breach of good faith exists where, without reasonable justification, one party acts in relation to the contract in a manner which substantially nullifies the bargained objective or benefit contracted for, or causes significant harm to the other, contrary to the original purpose and expectation of the parties;
- the obligation is mutual; and
- the scope of the duty will depend on the circumstances of each case.

264 (1998), 61 Alta. L.R. (3d) 1 (Q.B.).

265 The four letters were sent on 6 December 1971, 10 April 1992, 30 April 1992, and 21 January 1994.

Empire argued, among other things, that CWNG's rights under the Right of Way had either expired due to Empire's "open, notorious and complete possession of the lands" and that of its predecessors in title for over twenty years, without complaint or interference by CWNG, or been abandoned by CWNG by virtue of its failure to take enforcement action prior to the present proceedings.

The judge was not unsympathetic to Empire, and his comments suggested that he believed CWNG to be somewhat "inflexible" in trying to accommodate Empire's interests:

> We therefore have two competing interests. On the one hand there is the Defendant property owner who, since 1971, has operated a business which fronts on a major truck route, a location clearly essential to the success of its business.... [I]t is also essential for it to be able to display its merchandise on the property, so as to be visible to passing motorists. His evidence is, and I have no reason to disbelieve him, that approximately 90% of the frontage of the Defendant's property ... is taken up by the Plaintiff's easement. To totally prohibit the Defendant from the use of 90% of the frontage of its property would be a grave injustice and in my view it would in the circumstances be considerable over-kill.... On the other hand there is the matter of the Plaintiff's rights under the easement to have access to its right-of-way for the purposes already outlined. Furthermore, the Plaintiff's rights are intertwined with the right of the general public to be safeguarded to the greatest extent possible from the dangers presented by a gas line rupture....
>
> It is my view of the evidence that both interests can be accommodated by a reasonable compromise and it is unfortunate that the parties did not agree to same without trial.[266]

Notwithstanding the court's sympathy for Empire's position, the judge was not prepared to find that CWNG's rights under the Right of Way had expired or had been abandoned. According to the court, the delay in taking proceedings (referred to as the defence of laches) was not determinative of CWNG's rights, citing a case in which the Supreme Court of Canada had held that a forty-three year delay was not determinative.[267] Moreover, the court reasoned, delay had not prejudiced Empire in any respect. To the contrary, Empire had benefitted from the delay, having made full use of the property in that period. Although the court's determination on this point is correct, the court's comment on whether Empire had been prejudiced by the delay is interesting. It could just as easily be argued that Empire built its business on CWNG's lack of action. Had the rights been asserted much earlier, Empire may have moved elsewhere and would not be in a position where it stood to lose a part of its business if it was required, some twenty years later, to change the way it generated business for its operations.

One would have thought that in the circumstances Empire was prejudiced by the delay. However, in order to successfully establish *laches*, Empire would have to show that "in all the circumstances the consequences of delay must render the grant of relief

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266 *Supra* note 264 at paras. 21-22.

267 *Canada Trust* v. *Amanda Lloyd* (1968), S.C.T. 300, discussed *ibid.* at paras. 26, 30.

unreasonable or unjust."[268] As between Empire's concerns about its business versus the public interest in having a properly maintained gas line running through the city, it would not be unreasonable or unjust to conclude that despite the delay, the Right of Way should be respected.

On Empire's argument that CWNG had abandoned the Right of Way, the evidence suggested that gas had flowed through the pipeline during the period in question and CWNG conducted at least three inspections of its high pressure lines on the property every year. As a result, the court was not prepared to hold that the Right of Way had been extinguished.

Finally, in addressing the issue of whether to grant the request for injunctive relief restraining Empire from encroaching on CWNG's Right of Way, the court noted that the public interest in maintaining the gas line was paramount and the relief would be granted, but on a limited basis. Without citing any authority except "injustice," and without regard to his previous finding that CWNG had a valid Right of Way granting it exclusive possession of the Right of Way, the court held that Empire was nonetheless "entitled to store operable and/or readily moveable trucks and trailers or other vehicles, equipped with wheels and tires on all that portion of its property affected by the easement."

B. *STOTT* v. *BUTTERWICK*[269]

Although not an oil and gas case, this case deals with the very interesting issue of who owns a hole in the ground. The plaintiffs in this case, the Stotts, had a right of way over the defendant's land for the purpose of drilling, maintaining, and servicing wells and installing, maintaining, and servicing water pipes and connections. As well, they claimed the exclusive right to use the water from the well. They also claimed title to the wells.

The court correctly noted that the water itself was owned by the Crown under the *Water Resources Act*[270] and pursuant to that Act, the plaintiffs required a permit in order to extract the water from the defendant's land.[271] In addition, the court noted

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268 See the comments of McLachlin J.A. in *Ahone* v. *Holloway* (1988), 30 B.C.L.R. (2d) 368 (C.A.), discussed *ibid.* at para. 29.

269 [1998] A.J. No. 1017 (Q.B.), online: QL (AJ).

270 R.S.A. 1980, c. W-5 [hereinafter *Water Resources Act*]. Subsection 2(1) provides: "The property in and the right of the diversion and use of all water in the Province is hereby vested in Her Majesty in right of Alberta."

271 Subsection 2(2) of the *Water Resources Act* stipulates that the owner of land may extract water without a permit or licence for domestic purposes on that land. Since the plaintiffs were not the "owner" of the land on which the wells were situate, and the water was not being used on that land, the plaintiffs required a licence to extract water from the well. That right, therefore, could not be granted under the easement agreement.

that there was nothing in the grant of easement giving the plaintiffs "title" to the wells.[272] The wells, as such, are holes in the ground: air space, which was owned by the defendants. The plaintiffs were merely owners of an interest in land, namely the easement, and had only those rights which the easement granted, subject to any statutory restrictions or requirements as may be applicable.

VIII. ROYALTY CASES[273]

A. *SAHTU SECRETARIAT V. CANADA*[274]

This case focuses attention on the proper interpretation of the revenue sharing provisions of a modern land claim agreement, in this case the agreement between the Sahtu Dene and Metis and Canada.[275] Chapter 10 of that agreement requires government (Canada or the Northwest Territories depending upon which has jurisdiction) to pay to the Sahtu Tribal Council an amount equal to 7.5 percent of the first $2 million dollars in resource royalties received by government in any year and 1.5 percent of any additional royalties.

The term royalty is defined to mean "any payment, whether in money or in kind, in respect of production of a resource ... [including from] the Norman Wells Proven Area ... paid or payable to government as owner of the resource, but does not include any payment for a service, for the issuance of a right or interest or for the granting of an approval or authorization."[276]

The "Norman Wells Proven Area" is defined by the terms of the agreement (the "NWPAA") between Canada and Imperial Oil of 21 July 1944, pursuant to which the parties agreed upon the terms for the development of the Norman Wells pool. This development led to the construction of the Canol pipeline to Alaska to assist with the war effort and to provide security of supply to the Alaska panhandle area. Instead of adopting the standard forms and royalty arrangements of the then current oil and gas land regulations, the NWPAA provided that Imperial Oil should pay a base royalty of 5 percent plus a one-third share of the total well-head price received for substances "produced, saved and sold" less certain charges and expenses. Indeed, the NWPAA provided that the Crown was to be treated as the owner of one-third of the production.

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272 *Supra* note 269 at para. 2, the easement agreement provided in relevant part (note that the Stotts were successors in interest to the "Grantees"):

> The Grantors hereby grant unto themselves as Grantees for the benefit of the Dominant Lands an easement and right-of-way in, under, over, across and through the Servient Lands for the following purposes:
> (a) Drilling, maintaining and servicing two (2) producing water wells;
> (b) Installing, maintaining and servicing water pipes and connections; and
> (c) Connecting to power sources and lines.

273 In addition to the cases discussed in this article, see the additional Indian royalty cases canvassed in N. Bankes and D. Rae, "Recent Cases on the Calculation of Royalties on First Nations' Lands," (2000) 38 Alta. L. Rev. 258.

274 [1999] F.C.J. No. 121 (T.D.), online: QL (FCJ) [hereinafter *Sahtu Secretariat*].

275 Fort Norman, 6 September 1993.

276 *Ibid.*

The NWPAA was amended when Norman Wells was re-developed in the 1980s but the basic structure remained the same. Furthermore, unlike other oil and gas properties in the Northwest Territories, the NWPAA was completely grandparented through the *Canada Oil and Gas Act*[277] and the *Canada Petroleum Resources Act*.[278]

Both parties accepted that the 5 percent base royalty was subject to sharing, but Canada argued that the monies that it received from Imperial in respect of its one-third share were payments in respect of the sale of the resource and not payments in respect of the production of a resource. Canada also argued that these payments were not made to government as owner of the resource. Dube J. rejected both arguments.

1. ANY PAYMENT IN RESPECT OF PRODUCTION

Dube J. noted that the Sahtu agreement stipulated that government had an obligation to share "any payment" that it received in respect of production, while other cases suggested that "production" was a broad term. Thus Dube J. quoted *Texaco Exploration* v. *R.*[279] for the proposition that production "means the bringing forth, or into existence and human realization, from underground, a basic substance containing gas, and at the same time, other matter." In his view, the use of the words "any payment" contemplated a "broad reach" and the words "'in respect of' must be interpreted in the broadest possible manner."[280] In a later part of the judgment Dube J. went on to state that:

> If the defendant intended to exclude the annual payments in question from the all-embracing "any payment" paid or payable to government as owner of the resources under the "royalty" definition ... the defendants ought to have said so. The definition clearly excludes "any payment for service, for the issuance of a right or interest or for the granting of an approval or authorization." It is silent with reference to the annual payments paid or payable to government by Imperial Oil.[281]

2. PAID OR PAYABLE TO GOVERNMENT AS OWNER OF THE RESOURCE

If Dube J. gave short shrift to Canada's first argument, he took even less space to dispose of the second argument. Given Canada's concession in its statement of defence that "the defendant owns one third ... of the petroleum and natural gas produced," it followed from a literal interpretation of the Sahtu agreement that any monies paid to Canada with respect to this one-third of production must be paid to Canada as owner of the resource. In particular, Dube J. rejected the contention that the term "owner of the resource" referred to the Crown's title as owner of the land.

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277 S.C. 1980-81-82-83, c. 81, s. 64(5).

278 R.S.C. 1985, c. 36 (2d Supp.), s. 114(5).

279 [1976] 1 F.C. 323 (T.D.).

280 *Supra* note 274 at para. 15.

281 *Ibid.* at para. 22. At this point in his judgment, Dube J. is dealing with Canada's argument that if Canada were compelled to share, the Sahtu would be receiving double compensation insofar as they received a capital transfer in respect of the Norman Wells Proven Area under chapter 8 of the agreement.

3. THE AGREEMENT WAS NOT AMBIGUOUS

Dube J.'s treatment of this last argument turns in part on an earlier procedural ruling in the same case. In *Sahtu Secretariat*,[282] the plaintiffs brought an application for a ruling that the term "royalty" as used in the Sahtu agreement was not ambiguous. This application was presumably brought with the intention of excluding evidence as to the course of negotiations and perhaps earlier drafts of the final agreement or the agreement in principle, either simply to expedite the trial or for more partisan reasons. Jerome J. agreed with the applicant and, in the course of doing so, offered two comments on the definition. There is irony here since at trial, Dube J. seems to have accepted one of those comments and rejected the other, thereby establishing at the very least some judicial ambivalence as to the correct interpretation of the definition. Thus, while both Dube and Jerome JJ. agreed that the term "production" must be interpreted broadly to include a "plethora of processes,"[283] they emphatically disagreed as to the meaning of "government as owner of the resource."

Jerome J. stated as follows:

> On its face the literal meaning of the phrase "owner of the resource" is, owner of the land on which the mines and minerals (solid, liquid or gaseous) are found. It does not mean owner of the produced resources. The definition properly narrows the scope [of] "any payment" when it states that only payments made to the government as "owner" of the resources, or more clearly, owner of the land on which those resources are found, come within the definition of royalty.[284]

To Dube J., nothing could be less obvious, and in the result Canada was caught between a rock and a hard place. Having elected not to appeal Jerome J.'s ruling, perhaps fortified by his reasoning on this vital point, they were bound by the result; that is to say that the word "royalty" as defined in the agreement "is not ambiguous." But the parties were not bound by the reasons for the order, and with that introduction Dube J., as noted above, took the view that Canada had to share because it owned one-third of the produced resource as a result of the NWPAA.

Sahtu Secretariat is a very specific decision that turns upon the language of the two agreements. That said, note that other modern land claim agreements contain similar revenue sharing provisions and thus the ruling is of broader interest.[285] The earlier procedural decision is also noteworthy insofar as it stands in contrast to the practice in the Alberta courts. Here it seems that trial judges in royalty cases routinely let in evidence as to custom and practice in the industry and as to surrounding circumstances when interpreting and characterizing royalty agreements.[286]

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282 [1997] F.C.J. No. 897 (T.D.), online: QL (FCJ).

283 *Ibid.* at para. 4.

284 *Ibid.* at para. 5.

285 See, *e.g.*, Vuntut Gwitchin Final Agreement, 1993, c. 23, "Resource Royalty Sharing" and Nunavut Land Claim Agreement, art. 25, "Resource Royalty Sharing."

286 See, *e.g.*, *Scurry-Rainbow Oil* v. *Galloway Estate*, [1993] 4 W.W.R. 454 at 483-86 (Alta. Q.B.). See also *United Canso Oil and Gas* v. *Washoe Northern* (1990), 78 Alta. L.R. (2d) 79 (Q.B.).

B. *COACHLIGHT RESOURCES* v. *DUCE OIL*[287]

Although not a royalty case, this case contains interesting *dicta* on the basis for calculating battery fees in the context of an operating agreement. The court held that it was not unreasonable for the operator to charge fees based upon total emulsion volumes (*i.e.* oil plus water), rather than on oil volumes.

[287] *Supra* note 237.