RECENT JUDICIAL DEVELOPMENTS OF INTEREST TO OIL AND GAS LAWYERS

WILLIAM H. BONNEY, Q.C. and J. JAY PARK*

This article is a compilation of recent interesting and potentially influential decisions by Canadian courts. Of note also is a judgment by the House of Lords that appears to significantly restrain the applicability of Rylands v. Fletcher. *The authors have surveyed case law development in such areas as contracts, lands, leases and titles, fiduciary duties, tax, the environment, torts, surface rights, governmental regulation, offshore drilling, creditors' rights and administrative law.*

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We would point out that the views expressed in this article are those of the authors alone, and do not necessarily represent the opinions of Macleod Dixon or any client of Macleod Dixon.

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I. INTRODUCTION

The cases which have been decided by the courts in the past year offer direction to oil and gas lawyers in a number of interesting areas. There are cases that interpret provisions of articles II, III, IV, V, VI, VII, IX, X and XXIV of the Canadian Association of Petroleum Landmen ("CAPL") Operating Procedure.[1] Students of that document will find guidance from these cases. Fiduciary duties were the subject of a number of cases in the past year, and will probably continue to be so in coming years. Other areas of the law also produced some legal gems, including a House of Lords decision that appears to severely narrow the applicability of the *Rylands* v. *Fletcher*[2] case.

Following the format of prior years, and mindful of our publisher's constraints on prolixity, we have endeavoured to select only the judicial decisions of greatest significance to oil and gas practitioners in Canada and generally have not included foreign authorities. We have grouped the cases under the traditional headings for ease of reference and include the usual cautions: first, that certain of the decisions discussed under one heading may by their nature relate to other headings as well; and second, that reliance on our brief case summaries, as a substitute for a reading of the case itself, may be hazardous to your practice.

II. CONTRACTS

A. *APL OIL & GAS LTD.* v. *AMOCO CANADA RESOURCES LTD.*[3]

This case raised the issue of whether a gas well drilled by parties under a 1974 CAPL Operating Procedure was "a well required to preserve title" under clause 1010 or an independent operation under clause 1007. The facts are rather extensive and critical to the result. A Crown lease comprising sections 29, 32 and 33 was due to terminate on April 12, 1989, but was extended by Alberta Energy under section 96 of

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[1] The CAPL Operating Procedure is published in Calgary by the Canadian Association of Petroleum Landmen. It is designed to define the relationship of two or more parties holding joint interest in oil and gas property. It is currently in its fifth version (published 1990), with previous publications in 1969, 1971, 1974 and 1981.

[2] (1868), L.R. 3 (H.L.) 330.

[3] (1993), 16 Alta. L.R. (3d) 95 (Q.B.).

the *Mines and Minerals Act*[4] pursuant to a well drilled on 13-32. The department advised the working interest owners that if another well had not commenced drilling by June 18, 1989, an application to further continue sections 29 and 33 pursuant to section 95 of the *Act* must be received by that date. Paragraph 95(1)(d) provides that the Minister shall approve a continuation "if all or part of the spacing unit is considered by the Minister ... to be capable of producing (i) petroleum or natural gas in paying quantity." On May 8, 1989, L. Co. served an independent operations notice proposing a well on 13-33 as a title-preserving well and stating that subclause 1010(a) of the CAPL Operating Procedure would apply. On June 1, 1989, APL wrote L. Co. and the other partners proposing instead an application under section 95 to continue the lease. Considerable correspondence subsequently ensued with APL taking the position that the well could not be a title-preserving well because there was ample evidence from the well on 13-32 and other wells that an application under section 95 would be successful. An application under section 95 was in fact made and approved verbally by Alberta Energy on June 16, 1989, and on that date, after all parties had been advised of that approval, the well on 13-33 was spudded. APL did not participate in the well and brought an action for a declaration that it retained its working interest subject to a 300 percent penalty under clause 1007.

Virtue J. held that the question whether the 13-33 well was drilled as a title-preserving well was not so much a question of law but a question of fact depending upon the intention of the parties *at the time the well was drilled.* He examined the intentions of the parties and found that the controlling parties intended to drill the well in any event; one party because they wished to avoid drainage, another because the 13-33 well was an earning well under a farmout. Further, the approval under section 95 was communicated before the well was drilled. One defendant argued that the well was "commenced" before the approval was received by road preparation and other pre-drilling work. Virtue J. rejected this argument, noting that the wording of clause 1010 refers to "the drilling of a well" and not "the commencement of a well" to preserve title.

This decision is notable in two respects. Firstly, Virtue J. looked to the subjective intention of the parties rather than making an objective assessment as one might have expected. Secondly, Virtue J. effectively found that the status of a well proposed under an independent operations notice can be determined *after* the notice period has expired; or putting the matter another way, a party may be required to elect whether or not to participate before it knows what the consequences of its non-election will be, notwithstanding that such consequences may well influence the election it will make.

Virtue J. then proceeded to consider what the position of the parties would have been if he had found the well to be a title-preserving well. APL had argued that since defendant A had not yet been recognized by novation as a party to the operating agreement, it would not have been entitled to acquire APL's forfeited interest. Defendant A argued that it had acquired the interest of Dome Petroleum Limited

[4] R.S.A. 1980, c. M-15.

("Dome") under a farmout agreement and thereby took Dome's position under the operating agreement. In response, APL argued that consent requirements of clause 2401A of the CAPL Operating Procedure had not been complied with. Virtue J. then proceeded to review the many ways in which APL had by its actions recognized defendant A and concluded that APL would have been estopped from alleging a failure of written consent.

Counsel has advised that this case will not be appealed.

B. *NOVALTA RESOURCES LTD., NOVALTA RESOURCES INC.* v. *ORTYNSKY EXPLORATION LIMITED*[5]

This decision of Justice A.B. Sulatycky raises a large number of oil and gas well drilling issues, most of which involve the authority and responsibility of the operator and the obligations of non-operators under various versions of the CAPL Operating Procedures. The CAPL Operating Procedure in use in this case was the 1981 version.

The plaintiff, Novalta Resources Ltd. ("Novalta"), and the defendant, Ortynsky Exploration Limited ("Ortynksy"), drilled and completed or abandoned eight oil and gas wells in the Haddock/McLeod area of Alberta in 1988 and 1989. Novalta was operator. The wells were drilled under farmout agreements from third parties under which agreements the 1981 CAPL Operating Procedure and 1983 Petroleum Accountants Society of Western Canada ("PASWC") Accounting Procedure were adopted. The farmees' interests were earned in the proportion of 60 percent to Novalta and 40 percent to Ortynsky. Novalta invoiced Ortynsky for its 40 percent share of the expenditures, only some of which were paid. Novalta demanded payment of $543,150.43 and brought suit to recover the same. Novalta also sought a declaration that it held a valid and enforceable lien against the defendant's interest in the wells in respect of which monies were owing and directions for sale thereunder. Ortynsky defended on four grounds:

(1) Novalta lacked or exceeded authority granted to it by Ortynsky under the CAPL Operating Procedure such that the expenditures were for its own account rather than the joint account;

(2) Novalta failed to conduct its duties as operator prudently or in a good and workman-like manner in accordance with good oilfield practices;

(3) Novalta failed to honour various contractual commitments; and

(4) Novalta committed various accounting errors.

The Court reviewed extensively, on a well-by-well basis, the issues raised and found for Novalta on all but a very few of the issues. It is only issues arising under items (1)

[5] [1994] 6 W.W.R. 484 (Alta. Q.B.).

and (2) above that are of interest, and in particular item (1). The dispute over this item emanated from a disagreement between the parties on the nature and scope of authority conferred upon an operator and the obligation accepted by a non-operator upon the signing of an Authority for Expenditure ("AFE"). The resolution of this issue required the Court to conduct an extensive review of the 1981 CAPL Operating Procedure and in particular clauses 301, 304, 701, 901 and 902 thereof, the text of which was set out verbatim in the decision together with comparative clauses from the 1974 CAPL Operating Procedure.

Novalta argued that the signing and return of an AFE by a non-operator constituted the non-operator's approval and agreement for an operator to conduct the proposed operation for the joint account. The AFE approves the undertaking described. It is not the expenditures in any particular amount estimated therein which is authorized.

Ortynsky, on the other hand, argued that an AFE delegates authority to the operator and at the same time authorizes the operator to make expenditures of a total amount not exceeding that specified in the AFE plus 10 percent. Any expenditures in excess of the AFE amount plus 10 percent are outside the scope of the operator's authority and for the operator's own account.

As the Court observed at 488, "the conflicting views are a consequence of differing interpretations of the juxtaposition of *Renaissance Resources Ltd.* v. *Metalore Resources Ltd.*[6]... and *Passburg Petroleums* v. *San Antonio Explorations Ltd.*[7] ... with CAPL 1981 and its predecessor CAPL 1974" [footnotes added].

In the *Renaissance* case, which involved the 1974 CAPL Operating Procedure, the non-operator ceased paying its share of drilling costs when the pre-drilling cost estimate was reached. In that case, Justice Kidd cited with approval the American case of *M. & T. Incorporated* v. *Fuel Resources Development Company* which states:

> An AFE is a form which is widely used in the oil and gas industry when wells are drilled by multiple parties. The AFE sets forth the location of the well, its objective geological formation, an estimated depth at which that formation will be encountered, the estimated costs of drilling and completion, and miscellaneous other information. It is prepared by the "operator" of the well, and execution of the AFE by the non-operating owners of working interests in the underlying leaseholds is a written manifestation of their consent to participate in the well. It is axiomatic that drilling costs cannot be estimated with certainty and that an AFE is at best a good-faith estimate. AFE's are usually exceeded, often by very substantial amounts.
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> ...
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> In the oil and gas industry, it is understood and accepted that when one signs an AFE, he is committed to his proportionate share of the necessary costs in drilling to the objective specified in the AFE, unless

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6 [1985] 4 W.W.R. 673 (Alta. C.A.), aff'g 31 Alta. L.R. (2d) 226 (Q.B.) [hereinafter *Renaissance*].

7 [1988] 2 W.W.R. 645 Alta. L.R. (2d) 57 (Q.B.) [hereinafter *Passburg*].

the parties mutually agree to terminate drilling earlier or to attempt a completion at a shallower formation.[8]

Kidd J. held for the operator and the Court of Appeal agreed, stating:

We agree with the judge's conclusion that supplemental A.F.E.s in the setting of this case were only estimated expenditures and their absence was not to be treated as a limitation on the risk to either participant in the expenditures surrounding the well. The appellant knew from his resource development experience, or must be taken to have known, that this type of drilling is an expensive, risky, and a not altogether disciplined science.[9]

In the *Passburg* case, which involved the 1981 CAPL Operating Procedure, the AFE failed to disclose that the well would be directionally drilled. The well was dry, and when the defendant refused to pay that portion of the well costs attributable to the directional drilling, the plaintiff sued. The trial judge declined to follow *Renaissance* and appeared to distinguish it based on the two different versions of the CAPL Operating Procedure. Lutz J. said in the decision:

It is my view, the learned decision of my late brother Kidd and my brothers from the Alberta Court of Appeal had some striking differences on which it can be said to be distinguishable in [sic] the case under consideration. For example, the CAPL agreement, which was described as a 1974 edition, had different material requirements pertinent to these proceedings than the current CAPL agreement involved in these proceedings.[10]

This led to the argument by the defendant Ortynsky that the *Renaissance* decision has no application to cases involving the 1981 CAPL Operating Procedure.

Sulatycky J. rejected this argument and held that the *Renaissance* and *Passburg* decisions were perfectly compatible:

In *Renaissance Resources*, Kidd J. adopted the description of an AFE as a "good-faith estimate". A party who is not forthright in preparing an AFE (which Lutz J. found the Plaintiff in *Passburg Petroleums*) cannot be said to be acting in good faith. That being the case, it appears to me that there is no need to distinguish *Renaissance Resources* to come to the proposition in *Passburg Petroleums*, namely, that there is a defence to a claim based on an AFE where the claimant was not forthright in preparing the AFE. In my opinion the decisions in *Renaissance Resources* and *Passburg Petroleums* are perfectly compatible.

The decision in *Renaissance Resources* defines the effect of an AFE but provides for limitations on that effect if the AFE is not prepared in good faith or if it is prepared negligently. In *Passburg Petroleums* the AFE was clearly not prepared in good faith. Reduced to their essential points, the

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8 518 F. Supp. 285 (Col. Dist. Ct. 1981) at 289.

9 *Supra* note 6 at 675.

10 *Supra* note 7 at 648.

Passburg Petroleums decision fits neatly with the jurisprudence enunciated in the *Renaissance Resources* case.[11]

Sulatycky J. then proceeded to compare the 1981 CAPL Operating Procedure with the 1974 CAPL Operating Procedure to better determine whether *Renaissance* remains the law and concluded that it does.

Certain of his findings are of interest:

(1) He could not discern any intent under the 1981 CAPL Operating Procedure to alter the fundamental nature or effect of an AFE for drilling or completion operations.

(2) The 1974 CAPL Operating Procedure delegated exclusive control and management to the operator. The 1981 version dropped the word "exclusive" and added an obligation to consult with non-operators. This mandates a good faith consideration of non-operator's views and opinions, but after such consultation the operator's opinion prevails.

(3) The 1981 CAPL Operating Procedure provision calling for supplementary AFEs for cost overruns of 10 percent or more do not apply to drilling or completion operations.

While this last finding may be desirable in its result, we would suggest, with respect, that the reasoning of the trial judge is flawed. Sulatycky J. was clearly anxious to apply the *Renaissance* decision to resolve the case and was therefore at pains to find that none of the changes made in the 1981 CAPL distinguishes the *Renaissance* case. If Clause 301 were interpreted so as to require supplemental AFEs to be submitted for the approval of the Joint Operators where costs of drilling, completing or equipping a well exceed 110 percent of estimate, this could well have distinguished the *Renaissance* decision since the 1974 CAPL did not contain such a requirement. The trial judge resolved this issue by finding that the term "operation" in the last paragraph of Clause 301 meant an operation other than a drilling and completion operation. To reach this conclusion he held, correctly, we believe, that the second and third paragraphs of Clause 301 must be read together. He then noted the reference in the second paragraph to "operating expenditures" and held that the meaning of those words was governed by the definition of "operating costs" contained in Clause 101(1). Since that definition excludes drilling costs, completion costs and equipping costs, he concluded that drilling and completion undertakings are excluded from the effect of the last two paragraphs of Clause 301.

There are several difficulties with this analysis. Firstly, it is not correct to look to the definition of "operating costs" to attribute a meaning to the phrase "operating expenditures". We rather suspect that the reason the term "operating expenditures" was

11 *Supra* note 5 at 490.

used in Clause 301 to ensure that the reference would not be confused with "operating costs". Secondly, if Sulatycky J. is correct in construing the term "operation" in Clause 301 to mean an operation other than a drilling, completing or equipping operations, then it presumably has the same meaning elsewhere in the document. However, when one reads the 1981 CAPL as a whole, reference to "operation" throughout the document clearly evidence that the term "operation" or "operations" is not intended to have this restricted meaning. (See, for example, the definition of "Operator", Clause 304, Clause 311, Article IV, Clause 502, Clause 505 and Article XVII).

With respect to overexpenditures on operations other than for drilling or completions, the Court held that supplementary AFEs must be submitted and if approval is not obtained from the non-operator, it will not be liable for the excess unless by its conduct it can be found under general principles of law to have ratified the actions of the operator. In one instance, the judge found that the plaintiff had been careless in preparing an estimate of the cost for an access road. He then turned to the question of ratification and stated:

> In considering whether the doctrine of ratification applies in this instance, three factors must be examined. Firstly, did the Plaintiff purport to act for the joint account? Secondly, did the Defendant eventually acquire full knowledge of all the material circumstances? Thirdly, did the Defendant do anything which shows that it adopted the Plaintiff's act in whole or in part? If each question is answered affirmatively then ratification has taken place and the Defendant must indemnify the Plaintiff for its proportionate share of the costs.[12]

The judge found in the affirmative on the first two factors and then found evidence that Ortynsky adopted the action of the operator when it submitted an application for a Canadian Exploration and Development Incentive Program ("CEDIP") grant for its share of the costs of the well, including the road, and wrote to the CEDIP justifying the high access and road costs.

C. *DYNEX PETROLEUM LTD. (TRUSTEE OF)* v. *MORGAN HYDROCARBONS INC.*[13]

This decision of the Alberta Court of Appeal is of considerable significance to the petroleum industry, dealing as it does with the right to replace a bankrupt operator. The entire decision is only two brief paragraphs in length.

Dynex Petroleum Ltd. ("Dynex"), now bankrupt, was the operator under a CAPL Operating Procedure. Morgan Hydrocarbons Inc. ("Morgan") sought to replace Dynex as the operator. It is unclear from the very brief decision which version of the CAPL Operating Procedure was at issue, but the 1981 version appears to fit the references. Subclause 202(a) states that "the Operator shall be replaced immediately and another appointed immediately ... if the Operator becomes bankrupt." The Court of Appeal

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[12] *Ibid.* at 516.

[13] (4 October 1993), Calgary 14442.

agreed with the chambers judge that bankruptcy did not result in automatic forfeiture of operatorship, but it does bring into play subclause 206(a), which reads as follows:

> (a) If an Operator resigns or is to be replaced, an Operator shall be appointed by the affirmative vote of two (2) or more parties representing a majority of the participating interests, provided if there are only two (2) Joint-Operators to this Operating Procedure and the Operator that resigned or is to be replaced is one (1) of the Joint-Operators, then, notwithstanding the foregoing, the other Joint-Operator shall have the right to become the Operator.
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> (b) No party shall be appointed Operator hereunder unless it has given its written consent to the appointment; provided that if the parties fail to appoint a replacing Operator or if any appointed Operator fails to carry out its duties hereunder, the party having the greatest participating interest shall act as Operator pro tem, with the right, should a similar situation re-occur after a new Operator has been appointed, to require the party having the next greatest participating interest to act as Operator pro tem and so on as occasion demands.[14]

Ernst & Young, trustee in the bankruptcy of Dynex, argued that since it represented the greatest participating interest, it could, as trustee, retain operatorship under subclause 206(b). In rejecting this argument, the Court held that subclause 206(b) must be read compatibly with clause 202 and did not revive the right of the bankrupt or anyone standing in its shoes.

The trustee had also argued that, by analogy to the *Oakwood Petroleums*[15] insolvency, proceedings to remove Dynex as operator were stayed by subsection 69.3(1) of the *Bankruptcy and Insolvency Act* which reads as follows:

> (1) Subject to subsection (2) and sections 69.4 and 69.5, on the bankruptcy of any debtor, no creditor has any remedy against the debtor or the debtor's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged.[16]

The Court held that in the circumstances the proceedings were not stayed by subsection 69.3(1) because Morgan was not a creditor and the claim was not one that was provable in bankruptcy. Although the decision does not address the issue, we are advised by counsel that the *Oakwood Petroleums* proceedings were distinguished in argument because they had been conducted pursuant to the *Companies' Creditors Arrangement Act*.[17]

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14 *Supra* note 1.

15 *Norcen Energy Resources Ltd.* v. *Oakwood Petroleums Limited* (1988), 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.).

16 R.S.C. 1985, c. B-3, as am. by S.C. 1992, c. 27, s. 36.

17 R.S.C. 1985, c. C-36.

D. *GULF CANADA RESOURCES LTD.* v. *PEMBINA RESOURCES LTD.*[18]

This is another decision in which change of operatorship was at issue and illustrates the difficulties facing any non-operator seeking injunctive relief to restrain a transfer of operatorship. Gulf Canada Resources Ltd. ("Gulf") sought an interim injunction to prevent Pembina Resources Ltd. ("Pembina") from appointing Canadian 88 Energy Corp. ("Canadian 88") as operator under an operating agreement attached to a 1969 farmout agreement between Gulf and Western Decalta Petroleum Limited ("Western Decalta", now Pembina). The operating agreement had provided that Western Decalta would be the operator and that upon the operator disposing of the majority of its participating interest, the non-operator (Gulf) would become the operator. Over the years, by virtue of a variety of Pembina transactions, four working interest participants became recognized with Gulf owning 56.667 percent. Thus a two-party operating agreement became applicable to a multi-party situation. Pembina agreed to sell its interest to Canadian 88 and undertook in the sale agreement to take all reasonable steps to assist Canadian 88 to take over operations. Hunt J. held that Gulf must meet the three-pronged test for an interim injunction set out in *Ominayak* v. *Norcen Energy Resources Ltd.*:[19]

(1) a serious issue to be tried;
(2) irreparable harm; and
(3) balance of convenience.

Hunt J. found a serious issue to be tried. She stated:

> I reject the contention made on behalf of Canadian 88 that it is obvious from the Operating Agreement that the retiring operator can pick whomever it wishes to take over the operatorship in these circumstances, so long as that party meets the definition of "Non-Operator" in the Agreement. I also reject the suggestion that the contractual arrangements between Pembina and Canadian 88 necessarily carry particular weight in these circumstances, vis-à-vis a party such as Gulf which was not a party to those contractual arrangements. Other contentious matters include the effect of the provision in the Pembina-Canadian 88 letter agreement whereby Pembina undertook to assist Canadian 88 to become operator; whether that undertaking by Pembina has any application here since Canadian 88 ultimately acquired its rights pursuant to the right of first refusal and not the letter agreement; and whether, if the provision has any effect here, Gulf became entitled to the same kind of undertaking once it exercised its right of first refusal. A question has also been raised by Gulf as to whether there is a practice in the industry to the effect that the party with the largest interest should become operator; there is conflicting affidavit evidence on this point and it is a matter that cannot be decided summarily by a chambers judge.[20]

However, she held that Gulf was unable to show irreparable harm merely by the fact that the lands will be subject to an agreement to which Gulf was a willing party and which could have been amended had the parties wished.

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18 (1994), 152 A.R. 74 (Q.B.).
19 [1985] 3 W.W.R. 193, 36 Alta. L.R. (2d) 137 (C.A.).
20 *Supra* note 18 at 77.

It is unfortunate that none of the very interesting and relevant issues mentioned by Hunt J. in this case will be decided at trial. Counsel has advised that the case has been settled.

E. *SCURRY-RAINBOW OIL LTD.* v. *KASHA*[21]

This decision of Lefsrud J. in the Alberta Court of Queen's Bench is the first dealing with the enforceability of a gross royalty trust to be rendered since the decision of Justice Hunt in *Scurry-Rainbow Oil Ltd.* v. *Galloway Estate*[22] and is worth studying for that reason alone. The decision is somewhat confusing and adds little to jurisprudence on the subject. In fairness to Lefsrud J., knowing that the *Galloway* decision was before the Court of Appeal, he may have felt an understandable reluctance to conduct yet another extensive review of the law on this subject. The facts disclose that, in 1948, one Chester Frank Kasha granted a petroleum and natural gas lease to California Standard Company reserving a 12½ percent lessor royalty. In 1951, Kasha entered into a Gross Royalty Trust Agreement ("GRTA") with Montreal Trust Company, relevant portions of which read as follows:

> 2. The Owner ... doth hereby grant, bargain, sell, assign, transfer and set over unto the Trustee, its successors, and assigns forever all the estate, right, title, interest, claim and demand whatsoever, both at law and in equity of the owner and ... in and to the above-mentioned Twelve & a half (12½%) percentum gross royalty or share of production of Petroleum, Natural Gas or Related Hydro-carbons from any well or wells that may be drilled upon the said lands, or any part thereof To Have And To Hold the same with all and every benefit that may or can be derived from the same unto the Trustee, its successors and assigns forever subject only to the terms of this Trust Agreement.
>
> In the event that the lease hereinbefore mentioned is cancelled, terminated or in any manner whatsoever brought to an end, the Owner agrees that the petroleum, natural gas and related hydrocarbons or any or all of them in and under the said lands shall continue to be subject to a twelve & a half (12½%) percentum gross royalty and the said twelve & a half (12½%) percentum gross royalty shall be subject in all respects to the trust herein created and it is further agreed that any Owner's royalty payable under any future lease of petroleum, natural gas or related hydrocarbons or any or all of them under the said lands shall be subject to the trust herein created and the owner further agrees that he will not in future lease petroleum, natural gas or related hydrocarbons or any or all of them under the said lands without expressly providing for the payment of a twelve and a half (12½%) percentum owners *[sic]* gross royalty of the leased substances free and clear of all charges, restrictions or covenants of any kind whatsoever.
>
> 28. This Agreement shall enure to the benefit of and be binding upon the parties hereto and the heirs, executors, administrators and assigns of the Owner herein and the successors and assigns of the Trustee.

[21] (1993), 143 A.R. 308.

[22] [1993] 4 W.W.R. 454, 138 A.R. 321 (Q.B.) [hereinafter *Galloway* cited to A.R.].

The trustee filed a caveat claiming an interest in the mines and minerals under the GRTA. Lefsrud J. specifically noted that, at the time he executed the GRTA, Kasha signed a dower affidavit in respect thereof. Shortly thereafter, Kasha requested the trustee to issue all of the royalty certificates covering the entire 12½ percent royalty to himself. No production was achieved under the California Standard lease and it expired at the end of its ten year primary term. Other leases were entered into but none achieved production. Kasha died in 1975. Prior to his death, he transferred the majority of his unit certificates to other parties and some of those were further traded. In his will, Kasha bequeathed to his five children "all my other mines and minerals and Gross Royalty Trust interests." In 1980, Kasha's children granted another lease which was also unproductive but, in 1983, they granted separate leases to Penn West Petroleum Ltd., reserving a 20 percent royalty and production was obtained. By this time, however, litigation concerning gross royalty trusts was in progress and the royalties were paid into court. The contest was between the Montreal Trust Company representing the holders of certificates issued under the GRTA and the children of Kasha who had become the current mineral owners and who, without more, would be entitled to the royalties by virtue of their titles. Although the grounds on which the Kasha children contested the GRTA do not appear in the decision, counsel has advised that it was based on uncertainty.

Lefsrud J. made but scant reference to the *Hetherington*[23] and *Galloway* decisions. He referred to *Anson's Law of Contract*[24] as establishing that the object of the court in construing a written contract was to discover the intention of the parties. He then found that he was able to determine with certainty the intention of Kasha with respect to clauses 2 and 28 of the GRTA. He found, *inter alia*, the following:

(1) Kasha intended to, and did in fact absolutely, unequivocally and forever assign, transfer and convey, albeit to himself in the first instance, a 12½ percent interest in the lands. As a result, Kasha effectively and permanently placed the ownership of a 12½ percent interest in the lands in twenty-five royalty trust certificates which, in accordance with the GRTA, were legally and freely tradeable without causing the holders concern about the provisions of the *Land Titles Act*,[25] their interests in the lands being at all times protected by the caveat. This is an unusual analysis of the effect of the GRTA. The judge ignores the fact that the transfer of the royalty interest was to Montreal Trust Company and seems to find that the title passed to the trust certificates. He appears to equate the transfer of all of the interest of the owner in the 12½ percent gross royalty to the transfer of a 12½ percent interest in the land.

(2) Kasha intended that any owner's royalty payable under any future lease would also be subject to the GRTA.

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[23] *Guaranty Trust Company of Canada* v. *Hetherington* (1989), 95 A.R. 261 (C.A.), aff'g in part (1987), 77 A.R. 104 (Q.B.).

[24] A.G. Guest, ed., *Anson's Law of Contract*, 26th ed. (New York: Oxford University Press, 1984).

[25] R.S.A. 1980, c. L-5.

(3) Under clause 28 of the GRTA, Kasha covenanted not only for himself but also for his heirs, executors and assigns. It is noteworthy that this case is not a claim by a purchaser of the mineral fee seeking to challenge the validity of the trustee's caveat. It is an action by the trustee against the current mineral owners, who are the heirs of the owner, to enforce the GRTA. Presumably the GRTA could be enforced against the heirs as a matter of contract even if the caveat did not protect an interest in land since, pursuant to the *Devolution of Real Property Act,*[26] the heirs of Kasha take subject to all the obligations of Kasha.

(4) The presence of the dower affidavit is evidence of Kasha's intention under the GRTA to convey an interest in land.

(5) The trustee's caveat is valid and enforceable.

(6) The GRTA created an immediate vesting such that neither the rule against perpetuities or the *Limitation of Actions Act*[27] apply.

(7) The commercial context supports an intention by Kasha to create a permanent interest in land. Lefsrud J. appears to take judicial notice that no one would invest in GRT certificates if they thought such certificates would not be valid forever.[28]

This case is being appealed.

F. *NOVA SCOTIA BUSINESS CAPITAL CORP.* v. *COXHEATH GOLD HOLDINGS LTD.*[29]

This case, in the Nova Scotia Supreme Court, also deals with the issue of whether or not a royalty is an interest in land. The interest in issue is a "Net Smelter Return Royalty" on certain minerals licences and leases. It is especially interesting from two perspectives: first, it discusses the decision of Hunt J. in the *Galloway* case and the decision of the Supreme Court of Canada in *Saskatchewan Minerals* v. *Keyes*;[30] and second, it raises similar issues to those currently before the Alberta courts in the celebrated case of *Bank of Montreal* v. *Dynex Petroleum Ltd.*[31] and in a similar context.

In this case the plaintiff, Nova Scotia Business Capital Corp. ("NSBCC"), the holder of a debenture, applied to the Court to permit Coopers & Lybrand Limited, the receiver

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26 R.S.A. 1980, c. D-34.
27 R.S.A. 1980, c. L-15.
28 *Supra* note 21 at 313n.
29 (23 December 1993), Halifax 81401.
30 [1972] S.C.R. 703, 23 D.L.R. (3d) 573, [1972] 2 W.W.R. 108 [hereinafter *Keyes*].
31 Calgary 9301-08195 (Q.B.) [hereinafter *Dynex*].

under the debenture, to sell the assets of Coxheath Gold Holdings Ltd. ("Coxheath") free from any claims on production by various royalty owners. In 1986, one Dennis Forgeron held four exploration licences to search for minerals under the *Mineral Resources Act*.[32] By agreement dated April 1, 1986, Forgeron granted Coxheath the right to earn a 100 percent working interest in twenty-three mineral claims owned by Forgeron pursuant to the licences. Paragraph 2 of the agreement stated:

> 2. Forgeron shall grant to Coxheath the right to earn a One Hundred Percent (100%) interest in the Property in consideration of:...
>
> (c) the payment to Forgeron of a Five Percent (5%) Net Smelter Return Royalty on all production from the Property.

Coxheath completed its obligations and Forgeron transferred the licences to Coxheath on November 12, 1986. As in Alberta, the Department of Mines would not permit any reference in the transfer to the royalty. However, in August 1989, Forgeron filed the agreement with the Registrar of Mineral Titles in order to protect the Net Smelter Return Royalty. During 1990 and 1991, Forgeron transferred half of his Net Smelter Return Royalty to third parties who filed caveats with the Registrar of Mineral Titles to protect their royalty interests. Forgeron and such third parties appeared as intervenors in the action. The debenture given by Coxheath to the NSBCC specifically referred to the vendor royalty charges.

Counsel for the intervenors relied on the dissenting decision of Laskin J. in the *Keyes* case[33] and the decision of Hunt J. in the *Galloway* case to support the proposition that the royalties were interests in land. The Court distinguished the *Galloway* decision on the grounds that the payment there was made by a lessor and not by a lessee, and preferred the majority decision in the *Keyes* case to Laskin's dissent. The Court accepted the plaintiff's argument that a royalty consisting of a "net smelter return" dictates that the interest is with respect to minerals once extracted and not an interest in minerals *in situ*.

Accordingly, the judge granted the application and the receiver transferred the Coxheath assets free of the royalties.

It will be apparent that although this case may be distinguishable from gross overriding royalties and other royalties granted in an oil and gas context, it may be more applicable to net profits interests which are also before the Alberta courts in the *Dynex* case.

In the result, the observation by Hunt J. that "too heavy a reliance upon traditional legal concepts, crafted for another time and other circumstances, can prove unhelpful in resolving contemporary problems,"[34] appears to have fallen on deaf ears in Nova

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[32] S.N.S. 1975, c. 12.

[33] *Supra* note 30 at 710.

[34] *Supra* note 22 at 334.

Scotia. Whether the Alberta Court of Appeal is listening should soon be known. The appeal decision in *Galloway* should soon be available and will undoubtedly be discussed in the recent cases article next year.

G. *MESA OPERATING LTD.* v. *AMOCO CANADA RESOURCES LTD.*[35]

This is the appeal from a trial decision of Shannon J. which was reviewed in the recent judicial developments article two years ago.[36] It involves the proper calculation of an overriding royalty of 12½ percent of the gross proceeds realized upon the sale of petroleum substances which royalty was reserved by Mesa Operating Ltd. ("Mesa") from a sale of all of its Canadian oil and gas properties to Dome Petroleum Ltd. ("Dome"). The decision of Shannon J. was upheld on all points and the appellate decision requires little further review here other than to note the following. It will be remembered that Shannon J. had found that Dome had breached an implied obligation of good faith to Mesa in pooling on an acreage basis rather than on a reserves basis which substantially reduced Mesa's royalty. In upholding the decision of Shannon J., the Court of Appeal felt that the rule could be expressed much more narrowly than to speak of "good faith":

> I agree with the learned trial judge. My only hesitation is whether one need, in this discussion, employ the term "good faith". In my view, we should hold carefully to the distinction between the two sources of rules about contracts, the law and the contract. Sometimes a rule of law imposes a duty or a constraint upon the parties to a contract *despite* their agreement, as is the case of the rule about illegal contracts and unconscionable contracts. On other occasions, however, the courts impose a rule upon the parties because we conclude that this *fulfils* the agreement. In other words, the duty arises as a matter of interpretation of the agreement. The source of the rule is not the law but the parties. I worry that the term "good faith" in this case might blur that distinction.[37]

The Court found that the agreement granting the royalty created certain reasonable expectations between the parties as to its meaning and performance standards and should, therefore, be performed in accordance with those reasonable expectations.

Shannon J. had also found that no royalty was payable by Dome at the time when Dome's interest was on penalty. The Court of Appeal agreed but supported its conclusion with much more extensive analysis than that provided by the trial judge.

It was also suggested by Amoco Canada Resources Ltd. at trial that the Energy Resources Conservation Board ("ERCB") would have to be satisfied to a high degree of certainty as to a reservoir location before it could order a pooling on a reserves basis. The Court held that the burden of proof required by the ERCB is only a balance of probability with the onus on the person who suggests areal pooling is inequitable.

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[35] (1994), 149 A.R. 187, 19 Alta. L.R. (3d) 38.

[36] F.R. Foran, R.W. Block & P.W. Burgess, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (1993) 31 Alta. L. Rev. 153 at 163.

[37] *Supra* note 35 at 191 [emphasis in original].

H. *SHERMAN* v. *OGONOSKI*[38]

The plaintiff sold to the defendant certain lands by agreement for sale, a term of which provided that vendor "shall receive all payments to be made on all surface rents for oil wells, battery sites and access roads for the surface leases in existence as of April 30, 1974 and for the lifetime of the said wells." The plaintiff transferred title to the defendant five years later. The plaintiff sought a declaration of entitlement to the payments. The defendant raised a number of arguments:

(1) The sale agreement merged with the transfer which did not reserve any interest in revenues or payments to the plaintiff. In rejecting this argument, the Court referred to the rules for merger set forth by the Alberta Court of Appeal in *Morretta* v. *Western Computer Investment Corp.*[39] as follows:

> Firstly, the general rule or presumption is that the agreements in the sales contract are merged in the conveyance.
>
> Secondly, this general rule does not apply to collateral or independent undertakings in the sale contract and the presumption is they are not merged in the conveyance.
>
> Thirdly, both presumptions are overborne if the intention of the parties was to the contrary.[40]

The Court held that the covenant in the agreement for sale represented a collateral or independent undertaking in the sale contract, and in addition the intention of the parties was clearly against merger.

(2) The "lifetime of the wells" is meaningless and indeterminate. The Court disagreed. The lifetime of the wells is for so long as the leases remain in effect and the lessee has not ceased his use and occupation of the lands thereby determining the lease and rental payments.

(3) Lease renewals or increases in rental should accrue to the defendants. The Court rejected this argument. It noted that the leases provided for renewals. The plaintiff as a party to the leases had the right to apply for rental or compensation reviews pursuant to surface rights legislation. The defendant had no such rights.

(4) The covenant in the sale agreement offends the rule against perpetuities and constitutes an illegal subdivision of lands. The Court held that such payment arrangements which are fully contemplated by land titles and surface rights legislation in Alberta do not offend the rule against perpetuities or constitute a subdivision of land.

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[38] (1993), 143 A.R. 71, 11 Alta. L.R. (3d) 61 (Q.B.).

[39] (1984), 3 D.L.R. (4th) 738, 29 Alta. L.R. (2d) 193, (C.A.) [cited to Alta. L.R.].

[40] *Ibid.* at 203-04.

(e) It is an express or implied term of the agreement that the plaintiff pay taxes on the lands subject to leases. Alternatively, it is just and equitable that the plaintiff pay such taxes as the plaintiff has been unjustly enriched by the defendant having paid same over the years. This too was rejected. The Court noted that taxes were not discussed in the agreement — the agreement spoke of rental payments and no other obligations — and accordingly the defendant as landowner has the obligation to pay taxes and no unjust enrichment arises.

I. *CONMAC WESTERN INDUSTRIES* v. *ROBINSON*[41]

This Alberta Court of Queen's Bench decision is not an oil and gas case and will not be discussed here at any length as the facts are many and complicated. It is mentioned, however, as it reflects circumstances frequently encountered in the oil and gas business when parties proceed with a transaction in the mistaken belief that they are in fundamental agreement based on initial letters of understanding which are subject to formal documentation to follow and the process of negotiating formal documentation later discloses areas of fundamental disagreement. Although the parties were in general agreement as to the terms of a gravel lease and the plaintiff made prepayments of royalty thereon, they were later unable to reach a formal agreement on the terms of the royalty to be paid. The case raises, among others, issues as to formation of contract, validity and enforceability, estoppel, and restitution.

III. LANDS, LEASES AND TITLES

A. *PRISM PETROLEUM LTD.* v. *OMEGA HYDROCARBONS LTD.*[42]

This case is the appeal from a trial decision of Egbert J. that was extensively discussed in last year's recent cases article.[43] It concerned the issue of ownership of solution gas and specifically, the meaning of "oil" as defined in the gas unit agreement. It will be recalled that in a judgment with a somewhat perverse result, the trial judge had determined that Prism Petroleum Ltd. ("Prism") owned the solution gas and Omega Hydrocarbons Ltd. ("Omega") had to account to Prism for the proceeds of sale thereof, but that Prism had to reimburse Omega for the costs involved in producing the solution gas. Those costs exceeded Prism's entitlement by $835,641.54, thereby giving Prism a "pyrrhic victory". The Court of Appeal allowed the appeal. Omega contended that as the owner of the oil it was entitled to the solution gas. The gas unit agreement gave to the gas unit all petroleum substances excepting only those that qualified under the definition of oil. The Court of Appeal agreed with the trial judge, although for different reasons, that Omega was bound by the gas unit agreement and that the case therefore turned on whether or not solution gas was included in the definition of "oil" as provided in the gas unit agreement. "Oil" was therein defined as follows:

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[41] [1993] 6 W.W.R. 375, 9 Alta. L.R. (3d) 232.

[42] (1994), 18 Alta. L.R. (3d) 225 (C.A.).

[43] J.G. Friesen & J.S. Osler, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (1994) 32 Alta. L. Rev. 328 at 354.

> *Oil* means crude oil and all other hydrocarbons regardless of gravity that are or can be recovered in liquid form from the Unitized Zone through a well by ordinary oil production methods.[44]

The Court of Appeal held that the trial judge had been in error, firstly in concluding that the definition of "oil" focused on surface rather than reservoir conditions, and secondly in failing properly to apply the decision in *Borys* v. *C.P.R.*[45] The Court of Appeal focused on the word "recovered" which was linked directly to the "Unitized Zone" which directs one to reservoir conditions. The Court of Appeal found marked similarities between this case and the *Borys* case. It found that *Borys* supported the contention that "recovery" occurs at the bottom of the well-bore.

The Court of Appeal noted that *Borys* has stood unchallenged for forty years with the result that the concepts that solution gas is part of the petroleum recovered from a well and that one looks to reservoir conditions as the point of recovery have been a part of oil and gas law since that time. The Court of Appeal then quoted from *Chitty on Contracts* as follows:

> Where the same words have for many years received a judicial construction, the court will suppose that the parties have contracted upon the belief that their words will be understood in the accepted legal sense.[46]

Thus, in the last result, the pyrrhic victory of Prism's was removed and Omega in its turn won a pyrrhic victory since it retained the solution gas and proceeds of sale thereof but thereby lost the $835,641.54 of production costs relating to the solution gas which had been awarded to it by the trial judge.

B. *GARLAND* v. *JONES*[47]

On April 5, 1979, Wilfred B. Jones transferred title to lands which were subject to surface leases to William Rosser Jones, his son. Twelve days later, on April 17, 1979, Wilfred entered into an agreement with William under which it was agreed that Wilfred would retain all surface rights on the lands. Wilfred filed a caveat protecting his interest under this agreement. William sold the lands and by a series of transfers the title became registered in the plaintiff, Garland. The defendants are the beneficiaries of Wilfred's estate. The plaintiff argued that after transferring title on April 5, Wilfred had no further interest in the land and that the rights to surface rentals subsequently granted did not encompass an interest in land and as such would not support a caveat. The trial judge agreed with the defendant's argument and held that rent accruing due is an incorporeal hereditament and as such fell squarely within the definition of land contained in the Saskatchewan *Land Titles Act* which defined "land" as meaning "lands,

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[44] *Supra* note 42 at 229.

[45] (1953), 7 W.W.R. (N.S.) 546, [1953] 2 D.L.R. 65 (Alta. Prov. Ct.) [hereinafter *Borys*].

[46] A.G. Guest, ed., *Chitty on Contracts*, 25th ed. (London: Sweet & Maxwell, 1983) at 770.

[47] [1993] 7 W.W.R. 102, 111 Sask. R. 134 (Q.B.).

messuages, tenements and hereditaments, corporeal and incorporeal...."[48] Accordingly, the caveat was upheld.

C. *JACKSON ESTATE* v. *ANDERSON ESTATE*[49]

This case is the appeal of a case reviewed in last year's recent cases article.[50] The plaintiff's estate had brought an action to recover mines and minerals underlying four legal subdivisions in Saskatchewan which had erroneously been transferred to Anderson in 1960. The sale agreement reserved to Jackson all mines and minerals. When the agreement was paid out, the transfer to Anderson was executed, but it also included a conveyance of all mines and minerals. Ten years later, Jackson filed a caveat which noted the erroneous transfer. Anderson made no attempt to remove the caveat. The trial judge found for the plaintiff.

The Court of Appeal reversed the decision. Sherstobitoff J.A., for the Court of Appeal, held that the action was barred by section 18 of *The Limitation of Actions Act*.[51] Although there is an exception for property held under an express trust, the Court of Appeal held that the trust in this case, if there was one, was a constructive trust. In any event, the Court of Appeal held that the doctrine of laches barred the claim. Jackson had known since at least 1969 that the mineral title had been transferred to Anderson and took no action for recovery. In addition, the only parties who knew the true facts are dead.

Clearly the filing of a caveat by Jackson was an endeavour on his part to recover his minerals. In finding that this was not sufficient, the Court of Appeal was undoubtedly correct. A caveat does not create rights; it merely preserves what rights the caveator has, if any. The issue in the case was whether Jackson had any such rights (*i.e.* an entitlement to the minerals), and filing the caveat did not resolve that issue.

IV. FIDUCIARY DUTIES

A. *ONTEX RESOURCES LTD.* v. *METALORE RESOURCES LTD.*[52]

This case is a decision of the Ontario Court of Appeal regarding a mining case. The trial court's decision was reported in the 1990 recent cases article.[53]

Ontex Resources Ltd. ("Ontex") owned eighteen mining claims in Ontario. Metalore Resources Ltd. ("Metalore") had staked thirty-nine claims near the Ontex claims, and it contacted Ontex with a view to obtaining an option on the eighteen claims. After

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48 R.S.S. 1978, c. L-5, s-s. 2(1).
49 (1993), 113 Sask. R. 264 (C.A.).
50 *Supra* note 43 at 357.
51 R.S.S. 1978, c. L-15.
52 (1993), 13 O.R. (3d) 229 [hereinafter *Ontex*].
53 E.A. Leew & M.A. Thackray, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (1991) 30 Alta. L. Rev. 308 at 350.

negotiations occurred, Ontex and Metalore entered into an agreement (the "1981 Agreement") which gave to Metalore the right to explore on the eighteen claims. If Metalore completed certain mining operations and spent certain amounts on exploration, it would earn either (1) a 100 percent interest in the eighteen claims, subject to a net profits interest of 30 percent, or (2) a 60 percent working interest in the claims, with Ontex becoming its 40 percent partner. Metalore was also obliged to provide information to Ontex about the status of mining operations on an annual basis and whenever requested by Ontex.

The trial court found breaches of contractual obligations and other duties by Metalore and its president, George Chilian. After conducting the exploration operations contemplated under the 1981 Agreement, Metalore provided to Ontex its first annual report, prepared by the geologist who was working on the claims. The tone of the geologist's evaluation was pessimistic. This report neglected to include the optimistic evaluation of another more experienced geologist who had been hired by Metalore to evaluate the first report and the initial results. Metalore then entered into negotiations with Ontex to acquire Ontex's interest. During the following year while negotiations occurred, Metalore avoided doing any further exploratory work on those claims which according to the second geologist's report were particularly prospective of gold.

In 1983, Ontex and Metalore entered into a new agreement (the "1983 Agreement") which granted to Metalore a full 100 percent interest in the eighteen claims, subject to a 10 percent net profits interest to Ontex in those claims and the thirty-nine claims of Metalore. The 1983 Agreement eliminated the obligation to provide an annual report on operations but did require the provision of information to Ontex upon its request. Shortly after the 1983 Agreement had been signed, Metalore made a significant discovery on the Ontex claims. Metalore did not tell Ontex about the discovery; rather, it proceeded to stake 478 adjacent mining claims. Ontex only became aware of the discovery in 1986 when it became public knowledge. Chilian made a profit on trading in Ontex's stock in connection with the public announcement of the discovery. Ontex sued.

The decision of the trial judge[54] contained little good news for Metalore or Chilian. The judge found that:

(1) the 1981 Agreement and the 1983 Agreement created fiduciary duties between Ontex and Metalore;

(2) Metalore's conduct in withholding the optimistic evaluation of the claims constituted a breach of the fiduciary duties that it owed to Ontex;

(3) the withholding of information by Metalore was a fundamental breach of each of the 1981 and 1983 Agreements which had the effect of rescinding them;

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[54] (1990), 75 O.R. (2d) 513 (Gen. Div.).

(4) Ontex was entitled to the return of its entire interest in the eighteen mining claims;

(5) Metalore held the 478 adjacent mining claims on a constructive trust for Ontex; and

(6) Chilian was liable for $80,000 of punitive damages and Metalore was liable for the solicitor-and-client costs of Ontex.

The Ontario Court of Appeal reversed all of these findings. It did not condone the actions of Metalore and Chilian in any way (indeed, it referred to Metalore's conduct as occasionally deceitful) but it held that the consequences to Metalore of its improper actions should be different from those determined by the trial judge. The judgment makes interesting reading, with a number of matters which are directly applicable to oil and gas issues.

1. Fiduciary Duties under the Agreements

The 1981 Agreement gave to Metalore the exclusive right of possession of the eighteen claims for the purposes of exploration. If the contractually committed expenditures and activities occurred, then Metalore would have an interest in the claims. Although Ontex was entitled to information, it had no control over the manner in which Metalore conducted the operations and no responsibility (financial or otherwise) for the results of the exploration work. The Court of Appeal concluded that this "lease-option" agreement did not create a fiduciary duty at any relevant time.

It is possible that these circumstances may be analogous to the "pre-earning" situation between a farmor and a farmee under an oil and gas industry farmout agreement. Previous cases tell us that co-owners of oil and gas properties owe fiduciary duties to each other;[55] this decision suggests that no such fiduciary relationship necessarily exists prior to co-ownership arising. However, that does not mean that it cannot exist at that time where other circumstances may permit a court to find that fiduciary obligations are in effect. For example, the *Lac Minerals* v. *International Corona* case[56] created a fiduciary obligation based on the provision of confidential information without any co-ownership of land.

For similar reasons, the Court of Appeal determined that the 1983 Agreement (which granted a 10 percent net profits interest to Ontex) did not create fiduciary obligations. This too may be analogous to royalty interests and net profits interests in the oil and gas context.

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[55] *Bank of Nova Scotia* v. *Société General (Canada)*, [1988] 4 W.W.R. 232 (Alta. C.A.); *Luscar Ltd. and Norcen Energy Resources* v. *Pembina Resources Ltd.* (1991), 122 A.R. 83, 85 Alta. L.R. (2d) 46 (Q.B.); *Trilogy Resource Corporation* v. *Dome Petroleum Ltd.* (1990), 76 Alta. L.R. (2d) 140 (Q.B.), rev'd (1991), 83 Alta. L.R. (2d) 97 (C.A.) (new trial ordered).

[56] [1989] 2 S.C.R. 574, 61 D.L.R. (4th) 14 [hereinafter *Lac Minerals* cited to D.L.R.].

2. The Consequences of Withholding Information

There being no finding of a fiduciary duty, it follows that Metalore's failure to disclose information to Ontex could not be a breach of a fiduciary duty. However, the Court of Appeal did find that the withholding of information was a breach of the contractual obligations of Metalore under the 1981 Agreement. In the trial court's view, this resulted in the rescission of the 1983 Agreement, because the validity of that agreement rested on proper disclosure having been made under the 1981 Agreement. Metalore's intentional failure to comply with the 1981 Agreement could not permit it to benefit from the replacement of that agreement with the more favourable terms of the 1983 Agreement. The Court of Appeal noted that the 1983 Agreement resulted not from the negotiation between strangers dealing at arm's length, but from negotiation between parties to a then-existing long-term contractual relationship.

However, the Court of Appeal found that Metalore's breach of the 1981 Agreement did not result in the rescission of that agreement. The essence of the 1981 Agreement was to grant an exclusive right to acquire an interest in the eighteen claims in return for performing certain exploratory work and expenditures. In the words of the Court of Appeal: "the disclosure obligation ... was of considerably lesser importance in the contractual relationship...."[57] The breach of that obligation did not deprive Ontex of substantially the whole benefit that it was entitled to obtain. Accordingly, the 1981 Agreement was found to continue to be in effect.

It should be noted by oil and gas lawyers that the Court of Appeal quoted with approval the finding of the trial judge that:

> It is the practice in the mineral exploration industry that where agreements exist such as we have here (the 1981 and 1983 agreements), *the party in control of the property must make full disclosure of all the information it possesses regarding the property when seeking to purchase the other party's interest.*[58]

If this finding can be said to apply to the oil and gas business, it may have some interesting consequences when operators seek to purchase the interests of their non-operators.

3. Constructive Trust

The Court of Appeal considered the suitability of the constructive trust as a remedy for Ontex by thoroughly examining the *Lac Minerals* case, where a constructive trust remedy was employed. The Court of Appeal held that the three required elements existed for establishing a breach of confidence: the conveyance of confidential information; the communication of that information in confidence (which the Court of Appeal held to be analogous in this case to Metalore's obtaining confidential

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[57] *Supra* note 52 at 249.

[58] *Ibid.* at 254 [emphasis added].

information pursuant to the operations Ontex permitted it to conduct under the 1981 Agreement); and its misuse by the party to whom it was communicated (in this case through its non-disclosure to Ontex). However, the Court of Appeal noted that in the *Lac Minerals* case, La Forest J. only granted a remedy of constructive trust because it was sufficiently established that the confidee used the information "*to the detriment of the confider*."[59] In this case, the Court of Appeal was not convinced that Ontex was actually harmed by Metalore's breach. There was no finding at trial that, but for the actions of Metalore, Ontex would have acquired the 478 adjacent claims. The Court of Appeal went further to analyze Ontex's financial situation, and it was not satisfied that Ontex at the relevant times had the capability of financing a staking program in competition with Metalore.

Without sufficient evidence connecting the breach of confidence to the loss by Ontex of the opportunity to acquire the 478 claims, the Court of Appeal held that constructive trust was not the appropriate remedy. Ontex was entitled only to a restitutionary remedy of restoring Ontex's interest in the eighteen claims under the 1981 Agreement.

Some of the comments of the Court of Appeal suggest that its conclusion could have been different if more attention was given in the evidence presented by Ontex to the detriment it suffered from Metalore's breach, or that at least Ontex could have obtained damages for the loss of a possible joint venture in the staking program, had such a claim been pursued in court.

The Court of Appeal also criticized the trial judgment on the constructive trust issue for failing to grant any restitutionary remedy to Metalore for the work that it did on the claims, and for applying the constructive trust to claims that Metalore clearly was negotiating prior to the 1981 Agreement.

4. Punitive Damages

Chilian's "highly improper conduct" (in the Court of Appeal's words) in using his insider information to trade in Ontex stock was not considered by the Court of Appeal to be sufficient grounds for punitive damages. In order for punitive damages to be granted, there must be an actionable wrong that causes injury to the plaintiff.[60] The Court of Appeal held that Ontex was uninjured by Chilian's actions, and that Ontex had no cause of action against Chilian for his conduct. Accordingly, the punitive damages award was overturned.

On September 30, 1993, the Supreme Court of Canada refused an application for leave to appeal the Ontario Court of Appeal's decision on this matter.

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59 *Ibid.* at 257 [emphasis in original].

60 *Ibid.* at 267.

B. *EREHWON EXPLORATION LIMITED v. NORTHSTAR ENERGY CORPORATION*[61]

This case deals with a number of interesting fiduciary duty and CAPL Operating Procedure matters that frequently arise in dealings between co-owners of oil and gas property. It sheds light on some of the issues that up to now have been subject only to speculation about the courts' views.

Northstar Energy Corporation ("Northstar") was the operator of certain properties governed by a 1981 CAPL Operating Procedure and a 1983 PASWC Accounting Procedure. Northstar became operator pursuant to an exploration agreement with Erehwon Exploration Limited ("Erehwon"), who was the non-operator. Northstar also had a services agreement with Ed Pinchin, a geophysicist and the president of Erehwon, pursuant to which Pinchin provided geophysical consulting services to Northstar in respect of the Birch-Wavy properties which were the subject of the exploration agreement. ("Erehwon" is "nowhere" spelled backwards; those with a literary bent will recognize it as Samuel Butler's term for paradise in his satirical book, *Erehwon*).

A number of disputes arose between Erehwon and Northstar regarding activities under the exploration agreement and the CAPL Operating Procedure. At issue was whether:

(a) Northstar had acquired properties in violation of an area of mutual interest ("AMI") provision of the exploration agreement;

(b) the operator indemnity provisions of the CAPL Operating Procedure relieved Northstar of any liability that it had to Erehwon except where Northstar was grossly negligent or acted with wilful misconduct;

(c) certain accounting disputes regarding charges made by Northstar to the joint account were valid; and

(d) Northstar was obliged to share its markets for gas which Erehwon did not take in kind.

At the trial before the Alberta Court of Queen's Bench, Hunt J. evaluated the claims by examining first whether there existed a fiduciary relationship between Northstar as operator and Erehwon as non-operator, and then by considering the effect of that conclusion on the particular facts of each claim.

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[61] (1993), 15 Alta. L.R. (3d) 200 (Q.B.).

1. Existence of Fiduciary Duty

Hunt J. adopted the classic statement of Justice Wilson in *Frame* v. *Smith*[62] which established the common features which must exist in order to impose a fiduciary obligation on a new relationship. The test as set out by Wilson J. in the *Frame* decision reads:

> Relationships in which a fiduciary obligation have been imposed seem to possess three general characteristics:
>
> (1) The fiduciary has scope for the exercise of some discretion or power.
>
> (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.
>
> (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.[63]

Sopinka J. elaborated on the test in *Lac Minerals* at 63:

> It is possible for a fiduciary relationship to be found although not all of these characteristics are present, nor will the presence of these ingredients invariably identify the existence of a fiduciary relationship.
>
> The one feature, however, which is considered to be indispensable to the existence of the relationship, and which is most relevant in this case, is that of dependency or vulnerability.

The Court also cited with approval cases which suggest that fiduciary duties will seldom be imposed on experienced businessmen of similar bargaining power dealing at arm's length.

In this situation, the Court held that both parties were relatively experienced in the oil and gas business, with access to legal advice. However, evidence submitted at the trial led the Court to conclude that Erehwon had considerably less bargaining strength than Northstar.

Employing the principles set forth in *Frame*, Hunt J. determined that in many of its functions under the CAPL Operating Procedure, the operator is a fiduciary. However, in order to determine whether there exists a fiduciary duty in a particular situation, the facts of that situation must be evaluated.

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62 (1987), 42 D.L.R. (4th) 81, 78 N.R. 40 (S.C.C.) [hereinafter *Frame*].

63 *Ibid.* at 99.

2. Area of Mutual Interest

Erehwon asserted that Northstar acquired a certain section of land ("Section 24") in violation of the area of mutual interest ("AMI") provisions of the agreements that were in effect between the parties. Northstar disputed this contention. Hunt J. concluded that the AMI did in fact cover Section 24, and that the nature of the AMI gave rise to a fiduciary duty, which arose separately from the CAPL Operating Procedure. Applying the *Frame* test, the Court stated:

> In choosing to acquire the AMI lands the defendant had scope for exercising power or discretion unilaterally so as to affect the Plaintiff's legal or practical interests. The very nature of the circumstances in which this could, (and in this case did) occur puts the Plaintiff at the mercy of the Defendant. The Defendant could unilaterally choose to acquire interests in the AMI lands without notifying the Plaintiff, thus infringing not only the Plaintiff's contractual rights but also its right to decide whether or not it wished to participate in the acquisition of property to which it had potential rights.... In these circumstances, the Defendant's obligations were clearly those of a fiduciary.[64]

This finding is consistent with the decision of Egbert J. in *Luscar Ltd. and Norcen Energy Resources Ltd.* v. *Pembina Resources Ltd.*,[65] where an area of mutual interest was found to give rise to fiduciary duties.

The Court found that the appropriate remedy in this situation (as in *Lac Minerals* and *Luscar*) was to hold that Northstar held a one-third interest in Section 24 in trust for Erehwon, subject to Erehwon deciding whether it wished to participate in the lands. Erehwon was also found to be entitled to accounting and full disclosure by Northstar, including all geological and geophysical information possessed by Northstar, all internal memoranda and reserve estimates relating to the lands, and an accounting of revenues and expenses to the date of trial.

3. Meaning of Operator Indemnity

Before considering the accounting issues described below, Hunt J. dispensed with an argument that Northstar made in defence of any potential liability it may have for inappropriate charges made to the joint account. Northstar contended that whether or not it had complied with "good oilfield practice" in its operations, it could only be liable to Erehwon for a breach if Erehwon suffered a loss which resulted from Northstar's gross negligence or wilful misconduct. Northstar cited the provisions of clause 401 of the CAPL Operating Procedure in support of its position. Clause 401 of the 1981 CAPL Operating Procedure reads in part as follows:

> 401 LIMIT OF LIABILITY — *The Operator shall not be liable to the Joint-Operators for any loss or damage* incurred by any of them relative to any operations carried out pursuant to this Operating Procedure *except that*: ...

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[64] *Supra* note 61 at 217.

[65] (1991), 122 A.R. 83, 85 Alta. L.R. (2d) 46 (Q.B.) [hereinafter *Luscar*].

> (b) in addition to the provisions of Subclause (a) of this Clause, *the Operator shall be solely liable* for any loss or damage of whatsoever nature *when such loss or damage is caused by the Operator's gross negligence or wilful misconduct....*[66]

The argument of Northstar was that the amounts at issue relating to the accounting disputes are all liabilities incurred by the operator in the carrying out of operations pursuant to the Operating Procedure. As contractual liabilities, they are to be borne by the joint account unless they are due to the operator's gross negligence.

Hunt J. took exception to this argument. In the judgment, she stated:

> I reject the suggestion that Article IV was meant to relate to the standard of care applicable to the relations between the CAPL parties themselves, and in particular to the Operator's duty to the Non-Operators in carrying out the joint operations. In my opinion, Article IV is most likely intended to deal with third party losses.[67]

The Court's reasoning was based on the words of the CAPL Operating Procedure. Clause 304 obliges the operator to carry out all operations "diligently, in a good and workmanlike manner, in accordance with good oilfield practices."[68] This statement is inconsistent with the suggestion that the operator could then act in a grossly negligent fashion. It seemed more appropriate to the Court that non-operators would agree to indemnify the operator for third-party losses that result from negligence (as opposed to gross negligence), because many joint operations such as the drilling of wells are high risk. It would be unfair that the operator bear all of the liability for such losses when they are uninsured.

The Court could not apply this reasoning to the accounting relations between the parties. In the words of Hunt J.:

> It would give the Operator much greater power to act as it wishes vis-à-vis the Non-Operators than seems to me consistent with a reasonable commercial interpretation of CAPL. Potentially, it would give the Operator a sort of tyrannical role in relation to Non-Operators. I do not believe that this was the intention of the parties.[69]

Some operators believe that article IV gives them protection against liability to their non-operators for acts that are merely negligent as opposed to grossly negligent. This belief may be justified due to the nature of the operator's appointment and compensation: the operator is appointed from among the co-owners to manage the joint property on behalf of all the owners, and is paid a fee for operations which is intended only to compensate it for its expenses of acting as operator. Indeed, a report of the

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66 *Supra* note 1 [emphasis added].
67 *Supra* note 61 at 223.
68 *Supra* note 1.
69 *Supra* note 61 at 224.

Petroleum Joint Venture Association dealing with operator cost recovery[70] suggests that operators recover only a fraction of their actual costs of operations. If it is true that the operator is paid only for its costs of operations, it seems unfair that the operator should be liable to its joint operators every time that the operator "stubs its toe", figuratively speaking. Fact situations may exist where liability of the operator for acts that are merely negligent may result in an injustice. Obviously, the Court did not think that it was unjust to make the operator liable in respect of the accounting disputes described below. This decision, however, suggests that operators are liable for any breach of the standard of care set forth in clause 304 of the CAPL Operating Procedure, except where the liability that is created is owed to a third party.

4. Accounting Matters

Erehwon complained about Northstar's activities in respect of four accounting matters.

(1) *Well Operating Fees.* Four wells that were governed by the exploration agreement were tied into a gas plant which was operated by Northstar. Northstar, as operator of the wells, was entitled under the terms of the CAPL Operating Procedure and the PASWC Accounting Procedure to charge $225 per well per month for overhead. It was also entitled to charge for actual labour costs and contract services which were approved by the parties. Northstar began levying additional operating charges, being fees of $225 for "Contract Operating Overhead" and $600 for "Contract Operating". Also, the operator applied an additional overhead 20 percent charge for third-party goods or services that the operator incurred for the joint account. These charges were being applied pursuant to well operating agreements that Northstar entered into with itself. Northstar argued that $825 per well per month was a reasonable charge for operating a well. Evidence was given at the trial that other parties were prepared to charge $300 to $325 per month. The Court held that the operator was spending non-operator's money, and accordingly it was acting in a fiduciary capacity. Entering into a contract with itself without advance disclosure and approval did not meet the necessary standard of care of a fiduciary, and Northstar was found to be liable to Erehwon for the difference between $325 per month and the amount actually charged.

(2) *Well Drilling Costs.* Two wells were drilled by Northstar, with an affiliate of Northstar hired as the drilling contractor. No competitive bids were sought for the drilling costs. Erehwon complained about the high estimate contained in the AFE for the well, but signed it in order to ensure its right to participate. Once again, the Court held that the operator was a fiduciary because it was spending joint-account funds, and that entering into agreements with non-

[70] "Operator Cost Recovery — Discussions and Recommendations", Petroleum Joint Venture Association, January 1987.

arm's-length parties without competitive bids or prior approval of the other participants was a breach of its fiduciary duty.

In arriving at this conclusion, Hunt J. rejected the argument that Erehwon must pay for its share of the well costs whatever they were because it had signed the AFE. This argument is based on the decisions of the Court in *Renaissance* and *Passburg*. The breach by Northstar of its fiduciary obligations resulted in a stricter standard being applied in this case.

(3) *Coiled Tubing*. Erehwon complained about charges totalling $47,704 for coiled tubing that was installed and removed from one of the joint wells. Installation cost over $30,000 and, after the operation failed, the removal of the coiled tubing cost $17,000. The operation was not the subject of an AFE, and Erehwon claimed that if an AFE had been issued, it would not have participated in what it considered to be a foolhardy operation. Northstar claimed that at the time the operation was proposed, it was estimated to cost under $20,000, which was considerably less than the $25,000 threshold established by the CAPL Operating Procedure for the issuance of an AFE by the operator. It also argued that the removal of the tubing was a separate operation. The Court examined the basis upon which Northstar determined that the coiled tubing installation appeared to be a reasonable course of action to follow, and how Northstar developed its estimate of under $20,000 for the cost of the operation. Hunt J. held that Northstar was a fiduciary of Erehwon in respect of these activities (once again because they were being charged to the joint account), but that there was no breach of that duty by Northstar. The estimate for the coiled tubing installation, while lower than it should have been, was still properly below the $25,000 threshold, and the removal of the tubing was a separate operation. Accordingly, Erehwon's complaint about the costs charged to the joint account in respect of this matter was dismissed.

(4) *Royalty Overpayment*. Erehwon also complained that royalty payments made by Northstar in respect of one well on behalf of the joint account were too high because the costs of the pipeline and equipping were not deducted from the royalties at an accelerated rate once it became clear that the well was watering out. Northstar argued that the costs of the facilities should be charged over their fifteen-year "useful life", and that the Jumping Pound formula was widely accepted as the appropriate method for allocating these costs to royalty owners. Hunt J. found that the use of the Jumping Pound formula was proper, even where the facilities in question cannot be used for the long period over which the formula would depreciate them. She stated that this is the sort of risk that the industry must accept. Once again, Northstar was found to be a fiduciary in respect of its activities in paying royalties and calculating appropriate deductions but its actions in respect of these matters conformed with industry standards.

5. Gas Marketing

The gas marketing issue which is raised in this case is probably the matter with the greatest impact on the activities of the oil and gas industry. Disputes between operators and non-operators regarding the failure of a party to take its share of gas production in kind have become common. Most of these disputes have been resolved by agreement between the parties; this is the first case where the parties chose to have the court settle the matter.

A portion of the lands governed by the exploration agreement were dedicated to supply a gas purchase contract with TransCanada Pipelines Limited ("TCPL"). Gas produced from the other lands governed by the exploration agreement was sold by Northstar on behalf of the co-owners, as was gas which was excess to the supply requirements of the TCPL contract. For a period of years, Northstar sold the production and shared the contract prices it received with Erehwon. In fact, Erehwon assisted in the identification of markets for the gas produced from the jointly owned lands. Then, in July 1990, Northstar gave notice to Erehwon that its share of production, if not taken in kind, would be purchased by Northstar at the prevailing spot price. Sales to TCPL continued to be shared, however, because the exploration agreement specifically referred to this contract as one under which Northstar was to sell gas production from the joint lands. Northstar applied this new policy retroactively to June 1, 1990. Unable on short notice to find a contract at a price better than the spot price, Erehwon did not take its share of production in kind until November 1991. During this period, the spot price paid by Northstar varied from $0.95 to $1.10, while Northstar's average selling price for gas was $1.39 to $1.44. Northstar retained the difference between the price it paid to Erehwon and the price it received on resale.

Erehwon claimed that it was entitled to receive Northstar's average selling price for the gas that Northstar purchased from it. Erehwon claimed that clause 602 of the CAPL Operating Procedure (quoted below) entitled the operator to sell the non-operator's gas "to others" only if that gas was sold at the same price as the operator received for its own share. Only if the non-operator's gas is being used for field operations or other activities where the operator burns or consumes the gas, can the gas be purchased at the "field price prevailing in the area." Alternatively, Erehwon argued that the operator as fiduciary is prohibited from retaining any profits on the resale of the non-operator's gas. Erehwon also argued that a duty of good faith and fair dealing prohibited Northstar from retaining the profits of the resale and that the course of conduct followed by Northstar prior to July 1990 obligated Northstar to market Erehwon's gas thereafter on the same basis. Northstar argued that clause 602 entitled it to do what it wished with the gas that it purchased for its own account at the field price prevailing in the area.

In rejecting Erehwon's arguments, Hunt J. shed a great deal of light on the meaning of article VI of the CAPL Operating Procedure. Relevant portions of the 1981 CAPL Operating Procedure read as follows:

601 EACH PARTY TO OWN AND TAKE ITS SHARE — Each of the parties shall own its proportionate share of the petroleum substances produced from wells operated for the joint account *and*

> *shall have the right*, at its own expense, *to take in kind* and separately dispose of its proportionate share of production exclusive of the production which may be used by the Operator in developing and producing operations and of production unavoidably lost.
>
> 602 FAILURE TO TAKE IN KIND — When and so often as a Joint-Operator shall fail or refuse to take in kind and separately dispose of its proportionate share of any production, *the Operator shall have the authority*, revocable by that Joint-Operator at will (subject to existing sales contracts), *to sell* for the account and at the expense of that Joint-Operator its proportionate share of production *to others at the same price which the Operator receives for its own share* of the production *or to purchase the same for its own account at the field price prevailing in the area.* All sales made by the Operator of a Joint-Operator's share of production as aforesaid shall be for such periods of time only as are consistent with the minimum needs of the industry under the circumstances but in no event shall any contract for the sale of the Joint-Operator's share of production be made for a period in excess of one (1) year.[71]

The Court found clause 602 to be ambiguous (based in part on the testimony of one of the authors of this article, who was called as an expert witness at the trial) and that compelling commercial arguments existed to support the views of both Erehwon and Northstar. The following are some of the findings made by Hunt J. regarding the meaning of that clause:

(1) Based on the expert evidence provided, the "minimum needs of the industry" is unlikely to exceed one month.

(2) The last sentence of the clause (regarding the operator's right to commit the gas for a certain period) applies only to those situations where the operator is selling the joint operator's gas to others and not where the operator is purchasing gas for the operator's own account. Therefore, it would appear that where the operator is purchasing the non-operator's gas, it is subject to being interrupted at any time by the non-operator's decision to commence taking gas in kind.

(3) When applied to natural gas, the phrase "field price prevailing in the area" means the spot price. This conclusion eliminates the uncertainty which was attached to this term, which more accurately describes pricing in an oil marketing situation.

(4) Although the matter was not free from difficulty, and with strong arguments on both sides, it was concluded that there is no limit on what an operator may do with non-operator's gas that it has purchased "for its own account" pursuant to the provisions of clause 602. To limit the operator's rights to utilize that gas for the operator's own *use* would require the Court to, in effect, insert words which the parties have not placed in the clause.[72]

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71 *Supra* note 1 [emphasis added].

72 *Supra* note 61 at 246-47.

Also, the Court held that there is no fiduciary duty that applies in this case. Although the operator may be acting in a fiduciary situation where it sells the non-operator's gas "to others ... at the same price that the operator receives for its own share," no such duty necessarily exists where the purchase is made by the operator for its own account. Hunt J. also emphasized the importance of the words of clause 602 as potentially overriding any fiduciary duty that might exist.

> To determine the scope of the Operator's fiduciary duty in a marketing context, one has to look at the contract. While fiduciary obligations can arise in a commercial setting, the scope of the obligations thus created must be interpreted in light of the contractual context. *If a fiduciary duty would otherwise arise, and the contractual language specifically negatives this, in my opinion the fiduciary duty must give way to the contractual language the parties have chosen.* To follow any other course would create an unwarranted degree of judicial interference in commercial relations.[73]

The fact that the non-operator always had the right to take its share of gas in kind led the Court to conclude that there did not exist the kind of vulnerability that is thought to be necessary to create a fiduciary obligation. If there was vulnerability, the Court said, it was a vulnerability of the non-operator's own choosing.

The course of conduct of the parties prior to July 1990 was not found to be sufficiently unambiguous as to create an obligation to continue to market gas on the same terms thereafter.

The Court accepted that there was a duty of good faith requiring parties to exercise their rights under a contract honestly, fairly and in good faith. However, the Court found no compelling evidence of bad faith in the conduct of Northstar.

Hunt J. held that too short a notice period was provided by Northstar regarding its changed procedures for dealing with gas that non-operators failed to take in kind. There existed a good faith obligation to provide at least two months prior notice if Northstar wished to cease selling Erehwon's production to others at the same price that Northstar received for its own share, and commence purchasing at the spot price. Thus, Northstar's July 25 notice could only take effect for production not taken in kind after October 1, 1990.

Hunt J. denied Erehwon's request for punitive damages, on the basis that the matters where Northstar was found to have acted improperly were all matters of contractual interpretation, or matters where the Court was satisfied that there was no dishonesty or fraud on the part of Northstar.

At the time of writing, the Court's decision had not been entered on the judgment roll and, accordingly, the time for appeal has not commenced to run. Counsel has advised that it is likely to be appealed to the Court of Appeal.

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[73] *Ibid.* at 249 [emphasis added].

This decision may affect the conduct of many operators and non-operators who encounter take-in-kind difficulties in their joint operations. Failures to take in kind are practically inevitable in any joint ownership situation where the co-owners are selling their respective shares of production to different buyers. This case is quite definitive in establishing that an operator can profit on resale of a non-operator's production. The course of prior conduct between Northstar and Erehwon and the clear action of Northstar in reselling gas at a profit made this take-in-kind dispute one in which the non-operator's case was about as compelling a situation as can exist. However, each situation will still need to be determined on its own merits and there are situations in which the non-operator can be even more vulnerable to the operator than was the case here. Operators control the flow of production from the well and only they know whether the co-owners are taking their share of production in kind; without any obligation to notify a non-operator of a failure to take in kind, an operator could conceivably profit from its knowledge or its own actions in some situations.

C. *CONSOLIDATED OIL & GAS INC.* v. *SUNCOR INC.*[74]

This case involves a dispute that arose in consummating a deal struck during a golf game in 1969. It has been in litigation since 1971. Consolidated Oil & Gas Inc. ("Consolidated") agreed to buy some interests in oil and gas permits in the Canadian Arctic from King Resources Company ("KRC"). Consolidated paid $1.6 million as partial payment of the purchase price (out of a total purchase price of about $5.2 million (U.S.)) and for development expenses on the properties until a dispute arose regarding whether KRC was in breach of its obligations to Consolidated. Pending resolution of the dispute under litigation commenced in the United States, the disputed interests were held by Suncor Inc. ("Sun") pursuant to two agreements (the "1971 Agreements"), one between Sun and Consolidated, and the other between Sun and KRC. These agreements, the interpretation of which is the subject of this case, provided that Sun would hold the disputed interests in trust pending the outcome of the litigation. Depending on the outcome of the litigation, Sun would either return the disputed interests to KRC or to Consolidated. In certain situations, Sun was obliged to make certain payments to Consolidated to reimburse it for payments it had already made or would make in the future. If such sums became payable, KRC was to indemnify Sun for the amounts it might be required to pay to Consolidated.

KRC went into receivership. Consolidated pursued its claim against KRC in U.S. bankruptcy court and lost. It then commenced an action against KRC, again in U.S. bankruptcy court, for the damages it suffered as a result of KRC's failure to perform. Consolidated lost this action as well, and the appeal. After bankruptcy reorganization, Phoenix Resources Company ("Phoenix") succeeded to the interests of KRC.

In 1982, the federal government required all offshore permits to be reissued under the revised *Canada Oil and Gas Act*.[75] In the course of determining in whose name

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[74] (1993), 140 A.R. 188 (Q.B.).

[75] S.C. 1980-81-82-83, c.81.

the disputed interests were to be held (Sun's or Phoenix's), the solicitors for Phoenix and Sun prepared and arranged for the execution of documents that would have the effect of transferring to Phoenix the interests held by Sun. The documents were never registered, which the *Canada Oil and Gas Act*[76] states is a prerequisite to a valid conveyance. When it became apparent to the solicitors that the effect of the appeal court decision of Consolidated's second action, combined with a transfer of the disputed interests into Phoenix's name, might have the effect of triggering Sun's obligation to pay Consolidated and Phoenix's obligation to pay Sun under the 1971 Agreements, they agreed to destroy the conveyance documents. Consolidated, which by now had itself been through bankruptcy proceedings, commenced this action against Sun and Phoenix for breach of the 1971 Agreements.

Much of this judgment is occupied with the assessment of whether the complaints of Consolidated are barred by the U.S. legal principles of claims preclusion and issue preclusion, which are the American equivalents of *res judicata* and issue estoppel. In a thorough and careful review of this matter, Hunt J. concluded that these principles applied in this matter to preclude Consolidated from any claims that it may have arising prior to the discharge of KRC. The Court also found that limitation rules barred Consolidated's claim that Sun breached its obligations to transfer the property to Phoenix.

The only possible basis for a claim by Consolidated would be on the grounds of new events which occurred in relation to the preparation, execution and destruction of the conveyance documents which were to transfer to Phoenix from Sun the registered interests in the disputed property that was held in trust by Sun. This was referred to by the Court as the "COGLA Transaction". Consolidated argued that:

(1) the 1971 Agreements created a trust in favour of Phoenix and Consolidated in respect of the disputed interests and the rights and benefits that would flow form a finding that Consolidated had no interest in the disputed interests;

(2) it was a beneficiary under the 1971 Agreements, because it was entitled to a benefit that would follow from the transfer of the interests from Sun to Phoenix; and

(3) there was a fiduciary relationship between Sun and Consolidated.

In all of these cases, which were argued in the alternative, Consolidated claimed breach of the fiduciary duties that were owed to it.

Based on a review of the 1971 Agreements, the Court held that there was no intention that Consolidated was a beneficiary, other than in relation to Sun holding the disputed interests on certain trust conditions. Regarding the existence of a fiduciary

[76] *Ibid.* at s. 53.

duty, Hunt J. quoted the words of Wilson J. in *Frame* v. *Smith*.[77] Hunt J. found that the first two tests of a fiduciary relationship existed here but did not see vulnerability on these facts. All of the parties were sophisticated commercial entities of approximately equal bargaining power which had access to and utilized legal advice in relation to the preparation of the 1971 Agreements. They freely negotiated a form of contract that would resolve the dispute in which they found themselves. In a telling warning to all who draft commercial agreements, the Court concluded:

> It appears that these Agreements were drafted without contemplating the possibility that KRC might become bankrupt.... If it is now the case that the terms of the contract are inadequate, it is not because Consolidated was vulnerable.... Many parties undoubtedly regret, after the fact, the form of agreement they have signed. But that is no reason for a court to alter the bargain they have struck by rewriting their deal later through the finding of a fiduciary relationship.[78]

Consolidated's remaining argument was that the preparation and execution of the conveyance agreements in fact constituted the conveyance that triggered the payment obligations of Phoenix and Sun under the 1971 Agreements, and their subsequent destruction once they realized the impact that the conveyance might have could not alter its effect. At issue was whether the conveyance had actually occurred. The following are the relevant portions of sections 52 and 53 of the *Canada Oil and Gas Act* as quoted by Hunt J.:

> 52(1) *Where an interest holder* other than one to which section 39 applies *proposes to enter into an agreement* or arrangement *that may result in a transfer, assignment or other disposition of an interest* or a share in an interest, *the interest holder shall give notice of such agreement or arrangement to the Minister*, together with a copy of the agreement or arrangement or, if the Minister approves, a summary of its terms and conditions, and *no such agreement or arrangement shall have any force or effect with respect to such transfer, assignment or other disposition until it is approved or deemed to be approved under this section.*
>
> 53. *No interest or share in an interest passes without registration in the manner prescribed.*[79]

The Court concluded that these words were sufficiently clear to find that Phoenix did not become an interest owner in the disputed interests by virtue of the executed but unregistered transfer. Hunt J. admitted that this matter was not without doubt and that there may be circumstances where a contrary result would be appropriate.

Hunt J. considered Consolidated's claim that there was a breach of good faith by Sun in its performance of the 1971 Agreements. While confirming that there is an obligation on contracting parties to conduct themselves in good faith with respect to discretionary conduct under a contract, the Court found no discretionary power in Sun in this arrangement and, accordingly, no breach of the good-faith duty.

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77 *Supra* note 63.

78 *Supra* note 74 at 206-07.

79 *Ibid.* at 210-11 [emphasis in original].

D. *PRAIRIE PACIFIC ENERGY CORP.* v. *SCURRY-RAINBOW OIL LTD.*[80]

Scurry-Rainbow Oil Ltd. ("Scurry-Rainbow") was the manager/operator of certain lands governed by a British Columbia Crown lease pursuant to a 1973 joint operating agreement with Prairie Pacific Energy Corp. ("Prairie Pacific"). Scurry-Rainbow and Prairie Pacific owned an undivided 50 percent interest in the subject lease. A well was drilled in 1981 pursuant to this agreement but in 1987 the oil production rate had declined to an uneconomic rate, so the well was shut in.

The drill stem test that occurred during drilling of the well suggested that economic gas production was possible from the Upper Cadomin formation. It was agreed that a recompletion should occur, and an AFE for such a project was prepared by Scurry-Rainbow and approved by Prairie Pacific. However, Scurry-Rainbow decided that it was also interested in examining the Lower Cadomin formation, which the well logs suggested might be productive of oil. Scurry-Rainbow's interest in knowing about this zone resulted from its desire to bid on a lease of adjoining lands, which were not subject to any area of mutual interest with Prairie Pacific. Scurry-Rainbow had posted the adjoining lands and intended to bid on them jointly with another company who co-owned other interests in the area with Scurry-Rainbow.

Scurry-Rainbow decided to explore for oil in the Lower Cadomin formation, based on its assessment that there was no risk that water production may result and contaminate the gas zone which was the goal of the recompletion effort. This decision was made because it was Scurry-Rainbow's evaluation that there was sufficient hydraulic isolation in the well to prevent water escaping into the gas reservoir. Accordingly, Scurry-Rainbow prepared a workover program that included perforating the Lower Cadomin. The program was not provided to Prairie Pacific.

Only water was produced from the Lower Cadomin and the zone was abandoned. The recompletion was then undertaken in the Upper Cadomin; it initially produced a marginally commercial amount of gas but subsequent perforations resulted in water production that required that the well be abandoned. Prairie Pacific took the position that Scurry-Rainbow's unauthorized alteration to the workover program had resulted in water contamination of the Upper Cadomin. Prairie Pacific sued Scurry-Rainbow for breach of its contractual and fiduciary duties and gross negligence, claiming $413,500 for the loss of the Upper Cadomin formation and seeking punitive damages as well.

Employing the test for the existence of a fiduciary relationship established by Wilson J. in *Frame* v. *Smith*,[81] Mason J. held that the activities of Scurry-Rainbow in relation to the recompletion of the well were within the scope of the fiduciary duties of an operator. The Court also found that the unilateral change in the recompletion project after the AFE had been approved and the failure to provide the workover program and well operations reports was a breach of the contractual duties and fiduciary duties of

[80] (17 January 1994), Calgary 8901-00635 (Alta Q.B.).

[81] *Supra* note 63.

Scurry-Rainbow. Mason J. came to this conclusion notwithstanding his reluctance to extend the fiduciary relationship into the area of drilling operations decisions.

Having found a fiduciary relationship and breaches of fiduciary and contractual duties, the Court then had to assess the appropriate damages. Expert evidence was given regarding the source of the water that prevented the completion in the Upper Cadomin. The Court preferred the evidence of three experts who said that the water source was not the Lower Cadomin over the evidence of one expert who concluded that it was. Accordingly, Mason J. held that Prairie Pacific's loss did not include damages for the lost Upper Cadomin production because that loss did not flow from Scurry-Rainbow's breach. However, the Court decided that Prairie Pacific should have no obligation to pay any portion of the cost of the recompletion effort under the approved AFE. In arriving at this conclusion, Mason J. found that the method for determining damages for breach of fiduciary duty must be broader than the foreseeability test in negligence. The Court suggested, based on the evidence before it, that Prairie Pacific would not have participated in the recompletion project had it known of the intended perforations of the Lower Cadomin. Therefore, the appropriate damages flowing from the breach were held to be all of the costs of Prairie Pacific incurred by participation in the project. The Court declined to find exemplary or punitive damages in this case.

This case is interesting in so far as it establishes damages for breach of fiduciary duty that go beyond restitutionary principles. It is interesting to compare the result of this case with that of the Ontario Court of Appeal in the *Ontex* case.

This decision has not been appealed.

V. TAX

A. *ECHO BAY MINES LTD.* v. *THE QUEEN*[82]

In this case, the plaintiff taxpayer was engaged in the mining and processing of, and exploration for, precious metals in the Arctic region of Canada. In the taxpayer's 1976 through 1982 taxation years, it operated a silver mine in the Northwest Territories. All production of silver concentrate from the mine was sold to an arm's-length purchaser under long-term sales contracts; the price of the silver under these contracts was based on the market value of the silver at a time which was two months prior to delivery of the silver to the purchaser. For its 1978 through 1980 taxation years, the plaintiff entered into forward sales contracts for silver. No silver was delivered under these contracts; rather, the contracts were closed out as they became due (by purchasing silver for delivery on the spot market) or were rolled over for other contracts to be closed out at a future date. In its 1980 taxation year, the plaintiff realized a gain of approximately $30 million on settlement of forward sales contracts for delivery of silver in that year, which amount was included by the taxpayer in its income.

[82] (1992), 56 F.T.R. 114, 92 D.T.C. 6437 (F.C.T.D.).

The issue before the Court was whether income from the settlement of forward sales contracts in 1980 for the delivery of silver in that year should be included in computing the plaintiff taxpayer's "resource profits" for that year. The amount of the plaintiff's resource profits was relevant in determining its resource allowance deduction pursuant to paragraph 20(1)(v.1) of the *Income Tax Act*[83] and its earned depletion allowance under part XII of the regulations to the *Act* (the "Regulations").

The first issue which MacKay J. addressed was whether the expert evidence of the taxpayer's accountant was admissible, as the defendant had alleged that the issue was purely a legal one to which generally accepted accounting principles were not relevant. MacKay J. held that the evidence was admissible (in his view consistent with the direction of Dickson C.J.C. (as he then was) in *Canada* v. *McClurg*[84] that the courts should be desirous of assessing the economic and commercial reality of a taxpayer's actions) provided that those principles were not inconsistent with the provisions of the *Act*.

The plaintiff's accountant produced evidence to the effect that hedging the price to be received under contracts of sale was common practice in the mining industry, especially by producers. The undisputed evidence of the accountant was that, pursuant to generally accepted accounting principles, gains and losses from forward sales contracts could be considered a hedge and matched against production if the following four conditions were met: (1) the item to be hedged exposed the enterprise to price (or interest rate) risk; (2) the futures contract reduced that exposure and was designated as a hedge; (3) the significant characteristics and expected terms of the anticipated transactions were identified; and (4) it was probable that the anticipated transaction would occur.

The expert testimony suggested that the difference between a hedge and speculation was that in the former the company engaged in the hedge sells forward a product it has the capability and intention of producing; if it does not have the capability and intention, it is speculation. Furthermore, some reasonable relationship of the amount of actual future production and the production protected by the forward sales contracts was necessary in order to consider the forward sales contracts to be a hedge for accounting purposes.

MacKay J. held that the evidence established that the settling of the forward sales contracts by the plaintiff constituted hedging, even though there was not an exact matching of forward sales contracts to actual production. Having found the activities to constitute hedging, MacKay J. then considered whether there was sufficient inter-connection or integration with the business of production of silver that the hedging gain could be considered to be income from the business of production of silver.

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83 R.S.C. 1985 (5th Supp.), c. 1.

84 (1990), 76 D.L.R. (4th) 217, 91 D.T.C. 5001 (S.C.C.).

Despite the expert evidence, the defendant maintained that a narrow construction of the definition of resource profits was warranted. The phrase "resource profits" was defined in paragraph 1204(1)(b) of the Regulations at the time to be "the amount ... of the aggregate of ... incomes ... from the production in Canada of ... metals or minerals." After referring to several cases, however, MacKay J. pointed out that it was the production of minerals as an economic activity, not the physical acts of extracting and processing, to which the relevant provision referred and that the sale of the material is an integral part of that business.

MacKay J. held that production activities yield no income without sales and that, accordingly, activities reasonably interconnected with marketing the product, undertaken to assure its sale at a satisfactory price, to yield income and hopefully a profit, are activities that form an integral part of production which yields income and resource profits within the meaning of Regulation 1204(1) as it then read. MacKay J. drew support for this conclusion from the use of the words "aggregate" and "incomes" in the relevant provision and the explicit exclusion of certain activities ancillary to actual production (such as transporting and processing the minerals) pursuant to Regulation 1204(3), all of which suggested the implicit inclusion of activities ancillary to production in the phrase "incomes ... from ... the production in Canada of ... metals or minerals".

Finally, MacKay J. found the use of forward sales contracts to protect the price of the plaintiff's production to correspond to ordinary business practice and to accounting principles which reflected the commercial reality of the taxpayer's actions. The plaintiff's appeal was therefore allowed, but only to the extent that the gain from settlement of forward sales contracts corresponded to the plaintiff's actual silver production for its 1980 taxation year.

B. *PAN OCEAN OIL LIMITED* v. *THE QUEEN*[85]

This case considered the impact of an amalgamation under the *Companies Act* (Alberta)[86] on the ability of the amalgamated corporation to deduct exploration and development expenses pursuant to what are commonly referred to as the "successor rules" of the *Income Tax Act*. Pursuant to these rules, generally, a successor corporation and a second successor corporation are permitted to deduct, to the extent provided by the *Act*, the unused resource deduction pools of a predecessor corporation (the corporation from which the resource properties were originally acquired by the successor corporation). However, if the resource properties are acquired by a third purchaser (a third successor), no use may be made of the as yet undeducted resource pools by that or a subsequent purchaser.

The material facts of the case are as follows. As a result of a series of transactions, Pan Ocean Oil Ltd. ("POOL") became a wholly owned subsidiary of Pan Ocean

[85] (1993) 68 F.T.R. 1, 93 D.T.C. 5330 (F.C.T.D.).

[86] R.S.A. 1970, c. 60.

(Alberta) Ltd. ("Alberta"). Subsequently, POOL and others purchased a group of public companies (the "Dynamic Companies") which had been actively engaged in oil and gas development and mining exploration and development in Canada. As part of a reorganization, each Dynamic Company transferred its resource properties to a newly incorporated subsidiary (the "Dynamic Subsidiaries"). Each Dynamic Subsidiary, the shares of which were later transferred to another company, transferred its resource properties to POOL (the second successor) and subsequently the Dynamic Subsidiaries were liquidated and dissolved. POOL deducted a portion of the undeducted exploration and development expenses incurred by the Dynamic Companies and was subsequently amalgamated with its parent corporation, Alberta, pursuant to the *Act* to form the appellant taxpayer. Section 87 of the *Act* applied to the amalgamation. By notice of reassessment, the Minister of National Revenue denied the deductibility of the exploration and development expenses deducted by the appellant taxpayer. The taxpayer appealed to the Federal Court, Trial Division.

The issue to be determined by the Court was whether the taxpayer was entitled to deduct the expenses as second successor, or whether (by virtue of the amalgamation with Alberta) the taxpayer was a third successor and was therefore not entitled to deduct the expenses.

Jerome J. began by considering the effect of an amalgamation under corporate law. After referring to several authorities, including *The Queen* v. *Black and Decker*,[87] Jerome J. concluded that an amalgamated company is a fusion of two or more companies and that the resulting company is regarded as a continuation of the predecessors and not as a new company. Consequently, Jerome J. concluded that an amalgamation does not constitute an acquisition of property under corporate law and that the ability of the appellant taxpayer to deduct the expenses would therefore survive unless specifically prohibited by the successor rules or section 87 (the latter governing amalgamations) of the *Act*.

With respect to the effect of section 87 of the *Act*, the Court relied on *Canada* v. *Guaranty Properties Limited*[88] as authority for establishing that although paragraph 87(2)(a) of the *Act* deems the amalgamated corporation to be a new taxpayer with a fresh taxation year as of the date of amalgamation, it does not evidence an intention of Parliament to deem that the predecessor corporations cease to exist for taxation purposes.

Jerome J. then proceeded to consider the effect of the wording of the successor rules of the *Act*. The provision in question, subsection 66(7), began as follows at the relevant time:

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[87] [1975] 1 S.C.R. 411, 43 D.L.R. (3d) 393.

[88] [1990] 3 F.C.R. 337, 90 D.T.C. 6363 (F.C.A.).

> where a corporation (in this subsection referred to as the "second successor corporation") has at any time after 1971 acquired by purchase or otherwise *(including an acquisition as a result of an amalgamation described in subsection 87(1))*, from another corporation.[89]

Jerome J. held that nothing in the successor rules prohibited the appellant taxpayer from deducting the expenses as a second successor and concluded that in order to deem an acquisition where none exists, the relevant deeming provision must use clear and unequivocal language that leaves no room for uncertainty, language which was not found to be present in the successor rules.

C. *SAMEDAN OIL OF CANADA INC.* v. *ALBERTA (PROVINCIAL TREASURER)*[90]

The issue in this case was whether or not the taxpayer had filed its Alberta corporate tax return on time. The taxpayer's fiscal and taxation year ended on December 31, 1988 and, pursuant to the *Alberta Corporate Tax Act*,[91] its return for the 1988 taxation year was due within six months from the end of that year which, as was agreed by both parties, was June 30, 1989. The taxpayer mailed its 1988 corporate tax return by registered mail from the United States on June 30, 1989 and it was received by the respondent July 13, 1989. The respondent imposed a late-filing penalty on the taxpayer, based on the contention that the return was filed only when it was received by the respondent.

The taxpayer appealed the imposition of the penalty to the Court of Queen's Bench,[92] which upheld the imposition of the penalty and held that the provision in question connotes the requirement of actual delivery before filing and that the mailed document was consequently not considered to be filed until it was received. On appeal, the taxpayer maintained that as the current Alberta *Act* requires a return to be *filed* (rather than *delivered*, as was the wording in previous Alberta Acts), no actual delivery to the provincial authority was required by the filing due date.

The Court of Appeal found the words in question to be clear and precise requiring actual delivery of the return to the provincial authority in order to be filed and accordingly dismissed the appeal. The Court noted that the Alberta *Act* was amended in 1986 to specifically make subsection 248(7) of the federal *Income Tax Act*[93] (which deems anything sent by mail to be received by the recipient on the day it was mailed for purposes of the federal *Income Tax Act*) inapplicable for the purposes of the Alberta *Act*. This amendment was considered instructive by the Court of Appeal as to the true intent of the legislature. Finally, the Court pointed out that administrative guidelines are not determinative of legislative intent and therefore the statements contained on the face of the actual 1988 return were not found to be persuasive.

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89 *Supra* note 83 [emphasis added].

90 (1993), 102 D.L.R. (4th) 125, 10 Alta. L.R. (3d) 48 (C.A.).

91 R.S.A. 1980, c. A-17.

92 (1992), 1 Alta. L.R. (3d) 399.

93 R.S.C. 1985, c.1 (5th Supp.).

VI. ENVIRONMENTAL

A. *QUEBEC (ATTORNEY GENERAL)* v. *CANADA (NATIONAL ENERGY BOARD)*[94]

This was an appeal of a decision of the Federal Court of Appeal that ruled that the National Energy Board ("NEB") had exceeded the limits of its jurisdiction and authority in applying conditions to export licences that it granted to Hydro-Quebec for the export of power to New York and Vermont. One of the conditions under these licences granted by the NEB was that Hydro-Quebec, in constructing production facilities required for the export of power, submit the construction contracts to an environmental review process required under the *Environmental Assessment and Review Process Guidelines Order*.[95] The Federal Court of Appeal held that the NEB had exceeded the limits of its jurisdiction and authority in imposing such environmental requirements on the construction of facilities related to the export of power. The Federal Court of Appeal held that the NEB's powers were restricted solely to the export of resources.

The Supreme Court of Canada, in allowing the appeal, held that the Federal Court of Appeal was incorrect in interpreting the NEB's scope of authority so narrowly. Justice Iacobucci stated at 191 of the judgment:

> I am of the view that the Court of Appeal erred in limiting the scope of the Board's environmental inquiry to the effects on the environment of the transmission of power by a line of wire across the border. To limit the effects considered to those resulting from the physical act of transmission is an unduly narrow interpretation of the activity contemplated by the arrangements in question. The narrowness of this view of the Board's inquiry is emphasized by the detailed regulatory process that has been created. I would find it surprising that such an elaborate review process would be created for such a limited inquiry. As the Court of Appeal in this case recognized, the electricity must be produced, either through existing facilities or the construction of new ones, in order for an export contract to be fulfilled. Ultimately, it is proper for the Board to consider in its decision-making process the overall environmental costs of granting the licence sought.

The Court went on to state that the best approach for courts in determining the overall environmental costs of granting a licence sought is to simply ask whether the construction of the new facilities envisioned is required to serve, among other needs, the demands of the export contract in question. If this question is answered in the affirmative (as it was on the facts of this case), the Court felt that the environmental effects of the construction of such facilities were related to the export of resources and were thus properly within the scope of the NEB's powers and authority. In defining the jurisdictional limits of the NEB, Iacobucci J. stated that:

> The scope of its inquiry must not be narrowed to such a degree that the function of the Board is rendered meaningless or ineffective.[96]

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[94] [1994] 1 S.C.R. 159.

[95] SOR/84-467.

[96] *Supra* note 94 at 192.

The Court also noted that the NEB was the only forum in which the environmental impact attributable solely to the export of resources could be considered. It concluded that the NEB did not exceed its jurisdiction under the *National Energy Board Act*.[97] Finally, although the reinstatement of the NEB order was not a result sought by any party, the Supreme Court of Canada felt such a reinstatement was justified on the facts of the case and within the jurisdiction of the Court and so ordered.

B. *R.* v. *O'HARA*[98]

This decision of the Nova Scotia Provincial Court held that the accused, who was charged with obstructing an environmental inspector contrary to subsection 43(3) of the *Environmental Protection Act*[99] of Nova Scotia, was guilty. On the facts, the accused general manager of an industrial site was convicted of the strict liability offence of obstructing an inspector who had arrived at the site and who, upon presenting identification, wished to examine a reported oil spill on the premises. The accused told the inspector that he was late for a meeting and that as a result no investigation could proceed. The inspector was then told he had to get off the site with his vehicle. The Court held that in forcing the inspector off the site, the accused obstructed justice by not allowing the inspector to examine the site for the reported oil spill and also precluded him from taking any remedial actions that may have been required. The Court held that it was irrelevant that the oil spill was subsequently cleaned up by a third party and any resultant environmental damage thereby averted.

C. *R.* v. *PROCTOR AND GAMBLE INC.*[100]

The accused corporation entered a guilty plea to 43 charges arising from its operation of a bleached kraft pulp mill near Grande Prairie. The defendant, under the terms of a *Clean Water Act*[101] licence was obligated to perform a number of environmental tests on effluent it discharged into a river next to its facility. It initially did the required tests in house, but subsequently contracted this testing to an outside firm. Under this independent firm, a series of violations of the facilities' licence terms occurred. The total amount of damages imposed by the Court was $140,000. This was despite the fact that the Court agreed that this was not a case where the violations occurred because of some deliberate misconduct on the part of the defendant or its managers.

D. *R.* v. *BATA INDUSTRIES LTD.*[102]

The defendant appealed a prior conviction of causing or permitting the discharge of liquid industrial waste into the ground which might impair the quality of ground water

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97 R.S.C. 1985, c. N-7.

98 (1993), 119 N.S.R. (2d) 128.

99 R.S.N.S. 1989, c.150.

100 (1 March 1994), Grand Prairie (Alta. Prov. Ct.) [unreported].

101 R.S.A. 1980, c. C-13 (as rep. by *Environmental Protection and Enhancement Act*, S.A. 1992, c. E-13.3).

102 (1993), 14 O.R. (3d) 354, 11 C.E.L.R. (N.S.) 208.

contrary to subsection 16(1) of the *Ontario Water Resources Act.*[103] Two of its officers were also convicted at first instance of failing to take all reasonable care to prevent the corporation from causing or permitting such unlawful discharge contrary to subsection 75(1) of the same *Act.* The Ontario Court (General Division) allowed the appeal in part. In reviewing the sentence, the Court stressed the moderately serious nature of the offences and the fact they were not deliberate. The Court also felt that the lower court had not given enough credit to the defendants for their record as reasonable, responsible corporate citizens and emphasized the fact that the defendant had undertaken complete remedial action with respect to the damaged area at the cost of nearly $500,000 and that before the offence was committed the defendant's company had circulated instructions to all its related companies worldwide alerting them as to environmental issues and dangers. As a result, the Court held that the defendant's damages (paid in the form of a mandatory contribution to a local toxic waste disposal program) should be reduced from $120,000 to $90,000. In addition the total financial penalty imposed on the individual officers of the defendant company was reduced from $12,000 to $6,000.

E. *CANADA (ENVIRONMENT CANADA)* v. *NORTHWEST TERRITORIES (COMMISSIONER)*[104]

The defendant government of the Northwest Territories was the owner-operator of a sewage lagoon which had overflowed into an adjacent water inlet for the sixth time in the previous ten years. Most of the prior overflows were the result of excessive water build-up due to melting snow. The Court held that the defendant was guilty of breaching subsection 36(3) of the *Fisheries Act.*[105] The Court dismissed the defendant's argument that the factors which caused the overflow, namely an unusually warm spring and the melting of large amounts of snow, were "Acts of God" which absolved the defendant of liability on the facts. The Court held, following *McQuillan* v. *Ryan,*[106] that an "Act of God":

> is an event that has been 'caused directly and exclusively by such a direct and violent and sudden act of nature as could not by any amount of ability had been foreseen, or if foreseen that it would happen, could not by any amount of care and skill be prevented.'[107]

It held that, on the facts, the melting of snow was neither an unforeseen nor unpreventable event given its prior frequency. The defendant was fined a total of $89,000. In its decision, the Court discussed sentencing parameters under subsection 36(3) and held that the maximum fine had been raised to $300,000 and a mid-range offence warranted a fine in the $150,000 range. It also held that government defendants should receive no special considerations in sentencing.

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[103] R.S.O. 1980, c. 361.
[104] [1994] 1 W.W.R. 441, 12 C.E.L.R. (N.S.) 37 (N.W.T. Terr. Ct.).
[105] R.S.C. 1985, c. F-14.
[106] (1921), 64 D.L.R. 482 (Ont. C.A.).
[107] *Supra* note 104 at 455.

F. *SYNCRUDE ENVIRONMENTAL ASSESSMENT COALITION* v. *ALBERTA (ENERGY RESOURCES CONSERVATION BOARD)*[108]

The applicants objected to an ERCB decision to proceed with a hearing regarding a Syncrude Canada Ltd. ("Syncrude") application to amend a previously approved expansion of its facilities and operations which was initiated under the predecessor legislation to the then new Alberta *Environmental Protection and Enhancement Act* ("*AEPEA*").[109] This application was the first to call upon the Alberta Court of Appeal to interpret the effect of the *AEPEA*. It raised key issues regarding the relationship between ERCB processes and *AEPEA* processes. The trial judge granted leave to appeal to the applicant on the limited question of law as to the transitional arrangements between the *AEPEA* and its statutory predecessors. The Alberta Court of Appeal dismissed the appeal. The Court stated that legislation, in the absence of express provisions, should not be interpreted in a way that prejudices accrued rights or existing status. Syncrude had accrued rights and status under a legislative scheme that pre-dated the enactment of the *AEPEA* which contained no express provisions affecting Syncrude's established rights or status. The fact that the *AEPEA* included transitional provisions (subsection 243(1)) which indicated the legislature intended to pursue a fair and orderly completion of outstanding approval applications pending before the ERCB and to applications approved by the ERCB prior to the *AEPEA*'s coming into force led the Court to rule that the ERCB had jurisdiction to continue with the hearing.

G. *CAMBRIDGE WATER CO. LTD.* v. *EASTERN COUNTIES LEATHER PLC*[110]

Another case of interest is a recent decision by the British House of Lords. The defendant was an old established leather manufacturer which used a chemical solvent (abbreviated as PCE) in its tanning process from the 1950s until 1976. In the course of tanning there were regular spillages of relatively small amounts of PCE onto a concrete floor in the tannery. The total spillage over the period of years prior to 1976 was estimated to be at least 1,000 gallons. The spilled PCE, which was not soluble in water, seeped through the facilities' concrete floor into the soil below until it reached an impermeable strata fifty metres below the surface. From this location it percolated along a plume at the rate of about eight metres a day until it reached the strata from which the plaintiff water company extracted water for domestic use via a bore hole. The distance between the plaintiff's bore hole and the defendant's tannery was 1.3 miles and the time taken for the solvent to seep from the tannery to the bore hole was approximately nine months. The plaintiffs acquired the borehole site in 1976 and used the borehole water supply until 1983 at which time water tests indicated high levels of PCE in the water. The plaintiffs brought an action against the defendants claiming damages in negligence, nuisance, and under the rule in *Rylands* v. *Fletcher*[111] for contamination of the water extracted from the bore hole. The source of contamination was not disputed. At trial the plaintiff's claim was dismissed by the Court under all

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108 (1994), 17 Alta. L.R. (3d) 368.

109 S.A. 1992, c. E-13.3.

110 [1994] 1 All E.R. 53 (H.L.).

111 *Supra* note 2.

three heads. The Court of Appeal allowed the plaintiff's appeal under the head of the rule in *Rylands* v. *Fletcher* and held that the defendants were strictly liable for the contamination of the water percolating under the plaintiff's lands and awarded damages of over one million pounds against the defendants. The defendants appealed to the House of Lords. The House of Lords allowed the appeal. The decision was enunciated by Lord Goff, who began by interpreting the rule in *Rylands* v. *Fletcher*. He felt that the rule and nuisance were very similar and in fact that:

> [s]een in its context, there is no reason to suppose that Blackburn J. [in *Rylands* v. *Fletcher*] intended to create a liability any more strict than that created by the law of nuisance; but even so he must have intended that, in the circumstances specified by him, there should be liability for damage resulting from an isolated escape.[112]

Lord Goff went on to state that the most authoritative statement of the principle expounded in *Rylands* v. *Fletcher* was to be found in the Privy Council decision delivered by Lord Moulton in *Rickards* v. *Lothian*:

> It is not every use to which land is put that brings into play that principle. It must be some special use bringing with it increased danger to others, and must not merely be the ordinary use of the land or such a use as is proper for the general benefit of the community.[113]

Thus, the House of Lords very restrictively interpreted the rule in *Rylands* v. *Fletcher*. Its assertion that it was merely an enunciation of the then existing laws of nuisance calls into question whether the rule in *Rylands* v. *Fletcher* is a distinct rule at all, or merely a nuisance case decided on its own facts. The Court went on to confirm that a necessary ingredient of guilt in nuisance was foreseeability of damages. In continuing his assertion that the rule in *Rylands* v. *Fletcher* was an extension of nuisance, Lord Goff went on to find that foreseeability was required in cases involving the rule as well. On the facts of the case, the Lords felt that the damages were too remote for the defendant tannery to have foreseen the harm the PCE contamination caused the plaintiff. The Court stated at 77:

> Here we are faced with a situation where the substance in question, PCE, has so travelled down through the drift and the chalk aquifer beneath ECL's premises that it has passed beyond the control of ECL. To impose strict liability on ECL in these circumstances, either as the creator of a nuisance or under the rule in *Rylands* v. *Fletcher*, on the ground that it is subsequently become reasonably foreseeable that the PCE may, if it escapes, cause damage, appears to me to go beyond the scope of the regimes imposed under either of these two related heads of liability. This is because when ECL created the conditions which have ultimately lead to the present state of affairs — whether by bringing the PCE in question onto its lands, or by retaining it there, or by using it in its tanning process — it could not have possibly foreseen the damage of the type now complained of might be caused thereby.

112 *Supra* note 110 at 70.

113 [1913] A.C. 263 at 280 (P.C.).

The case has significant ramifications for environmental actions brought under common law. The House of Lords has sided with a confessed polluter of a dangerous solvent whose pollution affected a water supply used by a quarter of a million people. In addition to the landmark restrictive interpretation of the rule in *Rylands* v. *Fletcher*, this decision focused on foreseeability as influenced by specific facts, such as the occurrence of the pollution over a very long period in very small amounts, its unintentional nature in that the tannery was unaware of the underground seepage and subsequent movement of the PCE, and that the amounts of PCE ultimately found in the plaintiff's water supply were not at statute-defined "dangerous" levels.

VII. TORTS

A. *VOGEL* v. *CANADIAN ROXY PETROLEUM*[114]

In this case, the plaintiff sued the defendant for the loss of his Hereford/Brahma calf when the calf was found dead in the defendant's pump jack with its head stuck between the wrist pin and the weights. The issue before the Court was whether the owner/operator of the pump jack owed a duty of care to the owner of the calf and, if so, was there a breach of that duty.

The Court found that the calf had a right to be on the section of land occupied by the pump because of the existence of a grazing lease. The Court also noted that the mineral surface lease was granted to the defendant two and a half years before the grazing lease was granted to the plaintiff. The mineral surface lease required the lessee to observe the requirements of the *Public Lands Act* (Alberta)[115] which included erecting fences and cattle guards on the leased area at any places the minister may direct. However, there was no indication that the minister had given any such direction.

The Court found that the way in which the calf died was unusual but not unheard of, and the fact that the defendant had originally erected a fence at this location was indicative of its awareness that the activities it carried out on the site were dangerous and that the defendant could foresee harm coming to anyone or anything unsuspectingly coming onto the site. As such, the Court held that the defendant had a common law duty to provide and maintain adequate fencing to keep animals away from the equipment. The Court found that the fencing that had been provided by the defendant was inadequate for this purpose and awarded damages to the plaintiff.

This decision is being appealed.

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114 [1994] A.J. No. 237 (Q.L.), (14 March 1994), Drayton Valley (Alta. Prov. Ct.) [unreported].

115 R.S.A. 1980, c. P-30.

VIII. SURFACE RIGHTS

A. *MUNTEAN* v. *GNE RESOURCES LTD.*[116]

Moore J., for the Alberta Court of Queen's Bench, considered an appeal by a lessor from a decision of the Surface Rights Board (the "Board") with respect to an application for an increase in surface rent for oil well property pursuant to the *Surface Rights Act*.[117] The Board had increased the rent payable by $1,000 to $4,000 based on a fair annual investment return on the value of the leased land which was considerably lower than rents paid under leases of comparable size and location. At issue before the Court was the appropriate method of determining the amount of rent payable.

The subject property was 3.34 acres located in an industrial area in the City of Red Deer which was leased to GNE Resources Ltd. ("GNE") out of a larger 8.99-acre parcel owned by Muntean. The surface lease was dated September 20, 1985, and was a standard form Alberta surface lease for a renewable twenty-five year term and terminable by GNE. The surface lease allowed GNE to use the land for any purpose necessary for its operations.

Moore J. held that the "income stream" method of calculating the rent was not the test of first instance:

> The appropriate annual compensation must be determined in relation to what other tenants are paying to lease similar lands in similar situations. Only if there were no comparable commercial leases in Red Deer should the income stream method be used to determine annual compensation. If there are a number of deals made such that it can be said that the pattern has been established by negotiations between landlords and tenants, the Board should depart from such compensation only with the most cogent reasons. Awards should be made so that like situations are treated in like fashion. There should be uniformity in compensation.[118]

He then cited *Champlin Canada Ltd.* v. *Calco Ranches Ltd.*[119] as suggesting that once *prima facie* comparability is demonstrated, the burden will shift to show lack of comparability.

In determining what are "comparable leases", Moore J. held that an element of common sense must be applied, such comparison being analogous to a comparison of the sale of property. Although reclamation costs as well as rental amounts during the previous years were held to be irrelevant, factors to be examined included the lessee's motivation to rent, the market value of the property, when the lease was entered into, and the nature of the leased land and its size. Further, since paragraph 25(1)(d) of the *Act* allowed the Board to consider the adverse effect of the leased area on the remaining

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116 (1993), 143 A.R. 197, 11 Alta. L.R. (3d) 299 (Q.B.) [cited to Alta. L.R.].

117 S.A. 1983, c. S-27.1.

118 *Supra* note 116 at 302.

119 (1986), 72 A.R. 154, 46 Alta. L.R. (2d) 182 (Q.B.).

land of the owner, Moore J. found that the configuration of the lease diminished the highest and best use of the remainder of Muntean's land, thereby rendering it more difficult for Muntean to rent the remainder of the 8.99 acres.

By utilizing the method of comparable leases and considering the foregoing factors, Moore J. held that the appropriate rent was $15,050 per year.

B. *OH RANCH LTD.* v. *ALBERTA (SURFACE RIGHTS BOARD)*[120]

OH Ranch Ltd. ("OH Ranch") entered into a surface lease with Joffre Oils Ltd. ("Joffre") in 1981. Approximately three years later Joffre went into receivership after which no surface rent was paid for a seven year period. OH Ranch applied to the Board under the *Surface Rights Act*[121] for compensation under section 39 which provides:

> (1) When an operator fails to pay, within 30 days following the day on which it was due, any money under a compensation order or surface lease, the person entitled to receive the money may submit to the Board evidence of the failure.
>
> (2) When the evidence submitted is satisfactory in the opinion of the Board with respect to the failure to pay, the Board may direct the Provincial Treasurer to pay out of the General Revenue Fund the amount of money to which the person is entitled.

OH Ranch was only able to produce a copy of the lease attached to a caveat filed at the Land Titles Office, in which the space for compensation remained blank. Although OH Ranch referred to specific amounts received from Joffre for two parcels in two separate years, the Board ruled that the evidence presented was not satisfactory to establish the claim.

Approximately one year and nine months after the Board's decision, OH Ranch applied under the *Act* to have the Board reconsider its decision. A month and a half later, the Board declined to direct a rehearing. Within six months of the Board's reply, OH Ranch brought an application for judicial review of the Board's decision.

Virtue J. held that the application for judicial review was barred by operation of Rule 753.11(1) of the *Alberta Rules of Court* which provides:

> Where the relief sought is an order to set aside a decision or act, the application for judicial review shall be filed and served within six months after the decision or act to which it relates.

Adopting the decision of *Spanach* v. *Workers' Compensation Board*,[122] he found that the notice of the decision not to review by the Board was not a decision of the Board for the purposes of Rule 753.11(1).

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[120] (1994), 148 A.R. 315 (Q.B.).

[121] *Supra* note 117.

[122] (1987), 75 A.R. 212 (Q.B.).

In *obiter*, Virtue J. stated that if he had found otherwise, under the facts of the case, he would have found that the decision of the Board was not patently unreasonable and would have been given deference.

IX. GOVERNMENTAL REGULATION

A. *CANADA (ATTORNEY-GENERAL)* v. *PLACID OIL CO.*[123]

The plaintiff brought a motion before Master Funduk for summary judgment in a claim arising by virtue of section 83 of the *Energy Administration Act*[124] for the amount of $2,327,949.21 as overpayment of compensation to the defendant.

In 1982, the plaintiff and the Province of Saskatchewan entered into an intergovernmental agreement (the "Inter-Crown Agreement") on energy pricing and taxation which provided that oil classified as "conventional new oil" would entitle the producer to pay reduced royalties based on the New Oil Reference Price ("NORP") as defined in an agreement between the plaintiff and the Province of Alberta. "Conventional new oil" was given a specific definition but allowed discretionary classification as such by agreement between the plaintiff and the Province of Saskatchewan.

Saskatchewan passed a regulation whereunder the province could approve the classification of "new freehold oil" thereby reducing taxes payable by producers on such oil. In 1983, the province granted the defendant's request to reclassify certain of its oil as "new freehold oil" for the sole reason of putting such production in a net profit margin and making such oil eligible for NORP.

Correspondence ensued between the Province of Saskatchewan and the plaintiff whereunder the province requested that they agree under the Inter-Crown Agreement to classify all of the province's "new freehold oil" as "conventional new oil" to be eligible for NORP. Most of the correspondence indicated that the province's classification of "new freehold oil" was only with respect to oil produced where the operator incurred expenditures to maintain or improve production. However, in one letter from the province to the plaintiff outlining the specific wells, the production from which was reclassified by the province as "new freehold oil", reference was made to the defendant's wells as reclassified for "exceptional circumstances" not involving work and production expenditures. In reply the plaintiff, appearing to have overlooked the "exceptional circumstances" of the defendant, stated that it understood that the oil in question had been provided "new freehold oil" status by the province based upon substantiation from the operators that expenditures were required to maintain or improve production and agreed to recommend amendment to the regulation for the provision of NORP. No reference was made to the defendant in this reply and the regulation was amended pursuant to which the defendant received the benefit of reduced royalties.

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[123] (27 September 1994), Edmonton 8903-16739 (Alta. Q.B.).

[124] R.S.C. 1985, c. E-6.

Although Master Funduk found that the servant of the plaintiff was careless in not noticing the discrepancy in the letter from the Province of Saskatchewan referring to the "exceptional circumstances" of the defendant, he held that, notwithstanding the passage of a specific regulation by the plaintiff, the approval by the plaintiff of the province's request was on the understanding that all of the reclassifications of the province were based on expenditures being required by the operators to maintain or improve production. Accordingly, he held that the plaintiff was entitled to repayment of the compensation received by the defendant.

X. OFFSHORE DRILLING

A. *MOBIL OIL CANADA LTD.* v. *CANADA-NEWFOUNDLAND OFFSHORE PETROLEUM BOARD*[125]

Mobil Oil Canada Ltd. ("Mobil Oil"), on behalf of itself and other oil and gas companies (the "companies"), was the operator responsible for exploration and lands administration under a fixed term gas exploration licence pursuant to which a discovery well was drilled in 1982. At that time, the offshore activity was governed by the *Canada Oil and Gas Act*.[126] In 1984, as a necessary step to production, the companies applied for a "significant discovery declaration" ("SDD") with respect to the discovery well and surrounding sections to obtain a statutory interest in the offshore area. In 1986, the Minister of Energy, Mines and Resources made an SDD for only part of the requested sections by way of statutory instrument.

After the repeal of the COGA, the companies applied in 1990 under the successor *Canada-Newfoundland Atlantic Accord Implementation Act*[127] for an SDD comprising a larger number of sections. The chairman of the Canada-Newfoundland Offshore Petroleum Board ("CNOPB") refused to put the new proposal before the CNOPB stating that the application was not based upon the results of the drilling of an additional well. At issue before the Supreme Court of Canada was whether an SDD application under subsection 71(1) of the *Implementation Act* must involve an offshore well which has never been the subject of an earlier SDD and whether the procedural rights of the companies in the *Implementation Act* were observed by the chairman in rendering his decision.

1. Requirement of a New Offshore Well

Section 47 and subsection 71(1) of the *Implementation Act* provide:

47. In this Part,

...

[125] [1994] 1 S.C.R. 202.

[126] S.C. 1980-81-82-83, c. 81 as rep. by *Canada Petroleum Resources Act*, 1986, c. 45, s. 130 [hereinafter *COGA*].

[127] S.C. 1987, c. 3 [hereinafter *Implementation Act*].

'significant discovery' means a discovery indicated by the first well on a geological feature that demonstrates by flow testing the existence of hydrocarbons in that feature and, having regard to geological and engineering factors, suggests the existence of an accumulation of hydrocarbons that has potential for sustained production;

71.(1) Subject to section 124, where a significant discovery has been made on any portion of the offshore area that is [described in the exploration licence], the Board shall, on the application of the interest holder of the interest or the share thereof made in the form and manner and containing such information as may be prescribed, make a written declaration of significant discovery in relation to those portions of the offshore area in respect of which there are reasonable grounds to believe that the significant discovery may extend.

Iacobucci J., for the Supreme Court of Canada, did not follow the lower courts by deferring the determination of this issue to the CNOPB. Rather, as a question of law, he rejected the companies' interpretation that if at least one well had been drilled in a geological feature, "reasonable grounds" could be established under subsection 71(1) by seismic and other data. He held that, based on an analysis of the history and intent behind the *Implementation Act*, the definition in section 47 of "significant discovery" (as reinforced by other sections of the *Implementation Act*), the broader statutory context and the object and scheme of the *Implementation Act*, a new offshore well must be drilled to provide grounds to amend a previously granted SDD.

2. Procedural Guarantees

Section 124 of the *Implementation Act* provides a method by which a person receiving notification of an impending order, decision or action of the CNOPB may request in writing a hearing of an independent Oil and Gas Committee (the "Committee"). The section also directs the CNOPB to consider the recommendations of the Committee before making an order or decision or taking any action.

Iacobucci J. disagreed with the finding of the Newfoundland Court of Appeal that the application process was bifurcated in that the CNOPB had the initial role of determining whether a "significant discovery" occurred before the review by the Committee was available. Rather, he held that it was the intention of the offshore scheme that the Committee should be involved whenever technical decisions are at issue. However, he held that the determination of the issue of whether an SDD application can be made in the absence of a fresh well is a non-technical issue which could not have benefited from Committee input.

The Supreme Court of Canada held that the rejection of the consideration of a novel legal argument by the chairman without consideration by the CNOPB effectively interfered with the companies' procedural guarantees of natural justice and fairness. This was based not on any interference with vested rights, as the acquisition of new statutory rights were at stake, but rather as an improper subdelegation by the CNOPB to the chairman. These procedural rights were inferred from both the object and scheme of the *Implementation Act* and the common law. Notwithstanding this finding, however, he exercised a rarely utilized discretion not to impose a remedy responsive to the

breach of procedural fairness or natural justice since the CNOPB was bound in law in any event to reject the application in accordance with the decision of the Court.

XI. CREDITORS' RIGHTS

A. *AIR CANADA* v. *M & L TRAVEL LTD., MARTIN AND VALIANT*[128]

The decision of the Ontario Court of Appeal in this case, which was reviewed in the 1993 recent judicial developments article,[129] was affirmed recently by the Supreme Court of Canada. This case considered the extent to which directors or officers of a corporation which is holding funds impressed with a trust may be personally liable for a breach of the terms of such a trust.

Martin and Valiant were directors and officers of a travel agency. The travel agency entered into an agreement with Air Canada whereby the travel agency could issue Air Canada tickets directly to the public on behalf of Air Canada. This agreement provided that all funds received by the travel agency in connection with the issuance of such tickets would be held in trust for the benefit of Air Canada. Although a trust bank account was established for such purposes, all ticket sale proceeds were deposited into the general account of the travel agency.

When the bankers of the travel agency later attached funds in the general account, Air Canada sued the travel agency, as well as Martin and Valiant personally, based on a breach of trust in respect of the ticket sale proceeds which the travel agency had failed to remit and which had been appropriated by the bank.

At both trial in the Ontario District Court[130] and appeal in the Ontario Court of Appeal,[131] it was found that, notwithstanding the failure of the Air Canada agreement to expressly require that ticket sale proceeds be segregated from and not commingled with other funds, the ticket sale proceeds were impressed with a trust by virtue of the clear terms of the Air Canada agreement. Both the trial judge and the Ontario Court of Appeal concluded that the travel agency breached this trust by permitting the funds to be deposited in the travel agency's operating account and thereby become subject to appropriation by the bank.

The Supreme Court of Canada concurred with the finding in the Ontario Court of Appeal. By virtue of the degree of control over and knowledge of the details of the day-to-day operations of a closely held corporation which the directors and officers thereof enjoy, Martin and Valiant had sufficient knowledge of the trust imposed by the Air Canada agreement. By approving the actions of the travel agency which were in breach of that trust, Martin and Valiant knowingly participated in a breach of trust by the travel agency and could be held personally liable for such breach.

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128 [1993] 3 S.C.R. 787, 108 D.L.R. (4th) 592.

129 *Supra* note 36 at 191.

130 (6 April 1990), Belleville [unreported].

131 (1991), 2 O.R. (3d) 184, 77 D.L.R. (4th) 536.

The Supreme Court of Canada discussed the degree of knowledge of a breach of trust which is necessary in order to reach a finding of personal liability against the directors or officers of a trustee. The Court set the threshold for such knowledge quite low. It would appear that mere approval by the directors or officers of the execution of an agreement containing trust terms could be sufficient to imply knowledge of the trust, and any actions contrary to such trust conditions could attract personal liability for the directors or officers giving or consenting to such approval. In addition, the Court suggested that wilful blindness to a breach, or recklessness in failing to recognize a breach of trust conditions, may also attract personal liability to a director or officer. It appears clear that actual knowledge of the trust or the actions resulting in a breach thereof is not necessary in order to attract liability.

It is interesting to note the commingling provision of the CAPL Operating Procedure in the context of this case. Operators are entitled to commingle joint venture funds with their own. The 1990 revisions to the CAPL Operating Procedure add an acknowledgment that the joint account funds are trust funds notwithstanding such commingling, and include the additional stricture that such monies "shall be applied only to their intended use." In cases where operators become bankrupt or insolvent and the amount of joint-venture trust funds exceed the funds available, which is frequently the case, will the risk of personal liability of the operator's officers and directors be increased? Is that risk greater under the 1990 CAPL Operating Procedure? To what extent will the application of this case be limited to closely held corporations? Time will tell.

XII. ADMINISTRATIVE LAW

A. *CENTRA GAS ALBERTA INC.* v. *THREE HILLS (TOWN)*[132]

This case deals with the extent to which a regulatory body, in this case the Public Utilities Board ("PUB"), has the power to interpret contracts. Centra Gas Alberta Inc. ("Centra Gas") had a franchise for the supply of gas to the Town of Three Hills. The franchise agreement provided for a term of ten years, renewable for a further ten years unless the town chose to purchase the facilities of Centra Gas prior to the end of the first ten-year term. Any disputes under the agreement were to be referred to arbitration.

The town did not serve its notice to purchase within the required time. However, it did not apply for the required PUB approval of the renewal of the franchise. The PUB rejected an application by Centra Gas for this approval, concluding that only the town could apply. The town applied to the PUB for an order determining the amount to be paid by it to Centra Gas for the purchase of the facilities of Centra Gas, as permitted by the *Municipal Government Act*.[133] Centra Gas objected, suggesting that the renewal clause and arbitration provisions of the franchise agreement applied, and the PUB did

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[132] (1994), 147 A.R. 219 (Q.B.).

[133] R.S.A. 1980, c. M-26.

not have jurisdiction to deal with the interpretation of contractual matters. Centra Gas applied to the Alberta Court of Appeal for a declaratory judgment confirming its view.

The Court rejected Centra Gas's arguments. It found that although interpretation of contract issues was within the jurisdiction of the courts, its jurisdiction in these matters was not necessarily exclusive. Indeed, the Court quoted with approval decisions of the Supreme Court of Canada[134] that suggest that the courts should be reluctant to exercise a discretion on a subject that has statutorily been left to a specialized tribunal. Upon a review of the statutory scheme relating to the issues at hand, the Court determined that the PUB has been given the jurisdiction to interpret contractual and statutory provisions as part of its jurisdiction to approve contracts, renewals and purchases of facilities. Appeals are available to the Court of Appeal if a party thinks that the PUB has erred in law. Accordingly, the Court rejected Centra Gas' application and allowed the PUB to consider the town's application, which would likely require the PUB to evaluate contractual obligations arising under the franchise agreement between the town and Centra Gas.

B. *NORTHWESTERN UTILITIES LTD.* v. *ALBERTA (ENERGY RESOURCES CONSERVATION BOARD)*[135]

The ERCB granted an application by The Imperial Pipeline Company Limited to increase the pipe size of a previously approved oil pipeline from twelve inches to sixteen inches. Northwestern Utilities Ltd. ("NUL") had objected to the original approval for the twelve-inch pipeline on the basis that the pipe might be used for gas transmission, as opposed to liquid transmission, and thereby impinge on NUL's franchise in the area. The ERCB rejected NUL's argument in its original approval and decided that NUL had no interest in the amendment application. NUL appealed the decision.

The Alberta Court of Appeal dismissed NUL's appeal. The Court was not persuaded that the ERCB made any error of fact or law that constituted grounds for review. The ERCB stated that any alteration to the pipeline that would be required for it to become a gas transmission line would require ERCB approval. If such an application was made, then NUL would have an interest. The amendment application was not a substantive change to the pipeline, so NUL was not directly or indirectly affected by it.

XIII. LEAVE TO APPEAL TO SUPREME COURT OF CANADA

A. *ONTEX RESOURCES LTD.* v. *METALORE RESOURCES LTD.*

Leave to appeal to the Supreme Court of Canada was denied on December 23, 1993.

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134 *Lethbridge* v. *Canadian Western Natural Gas*, [1923] 3 W.W.R. 976; *Terrasses Zarolega Inc.* v. *Olympic Installations Board* (1981), 124 D.L.R. (3d) 204.

135 [1993] A.J. No. 651 (QL).

B. *WHITE RESOURCE MANAGEMENT LTD.* v. *DURISH*

Notice of appeal filed November 12, 1993.

C. *CARRIER-SEKANI TRIBAL COUNCIL* v.
CANADA (MINISTER OF THE ENVIRONMENT)

Leave to appeal to the Supreme Court of Canada was denied February 4, 1993.

D. *EASTMAIN BAND* v. *CANADA (FEDERAL ADMINISTRATOR)*

Leave to appeal the Supreme Court of Canada was allowed on October 14, 1993.