RECENT JUDICIAL DEVELOPMENTS OF INTEREST TO OIL AND GAS LAWYERS

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This article provides an overview of recent judicial developments of particular interest to oil and gas lawyers. The authors summarize and comment on recent Canadian case law in the areas of: aboriginal, administrative, contract, environmental, unit agreement, right of first refusal, surface rights, taxation, joint operating agreement, tort, farmout agreement, royalty, and limitations law.

Cet article donne un aperçu des récents développements judiciaires intéressant tout particulièrement les avocats travaillant dans le domaine pétrolier et gazier. Les auteurs résument et commentent la récente jurisprudence canadienne dans les domaines du droit autochtone, administratif, contractuel, environnemental, fiscal, du droit de préférence, des accords d'union, des droits de superficie, des ententes d'exploitation en commun, de délit civil, de redevances et de droit sur la prescription des actions.

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I. ABORIGINAL LAW

A. *ERMINESKIN INDIAN BAND AND NATION V. CANADA*[1]

1. BACKGROUND

Two Indian bands claimed that the Crown had a fiduciary obligation to invest the royalties it received on their behalf in a diversified portfolio. They claimed that the Crown's failure to make these prudent investments had deprived the bands of hundreds of millions of dollars since the 1970s.

2. FACTS

The bands were signatories to *Treaty No. 6* in 1876.[2] Pursuant to the *Treaty* and to the *Indian Act*,[3] the mineral rights of the band were surrendered to the Crown so that, among other things, the Crown could enter into agreements on behalf of the bands for the exploitation of oil and gas resources. The royalties paid to the Crown were deposited into the Consolidated Revenue Fund and interest was paid on that money based on the market yield of long-term government bonds.

In 1989 and 1992 the bands issued statements of claim, alleging that the Crown had breached its fiduciary duty to invest these royalties in a diversified portfolio as a prudent

[1] 2009 SCC 9, [2009] 1 S.C.R. 222 [*Ermineskin*].
[2] *Treaty No. 6*, Her Majesty the Queen and the Plain and Wood Cree Indians and other Tribes of Indians, 9 September 1876, online: Early Canadiana Online <http://canadiana.org/record/39206> [*Treaty*].
[3] R.S.C. 1985, c I-5.

investor would have done. This failure had cost the bands sums ranging from $156 million to $1.53 billion.[4]

3. DECISION

The Supreme Court of Canada determined that the Crown was neither a common law trustee nor was it bound by the duties of such a trustee. Moreover, while the Crown had conceded that it did have fiduciary obligations regarding the royalties belonging to the band, the Court held that these obligations were limited by various pieces of legislation, including the *Financial Administration Act*.[5] It was noted that the Crown is not an ordinary fiduciary since it has numerous roles and represents many interests, some of which cannot help but conflict.

The Supreme Court of Canada determined that the Crown's decision to pay interest based on the return offered by long-term government bonds was a reasonable treatment of the royalties, since, according to s. 90 of the *Financial Administration Act*, the Crown cannot use the royalties to invest in shares of a corporation. No unjust enrichment was found.[6]

4. COMMENTARY

The decision ends only part of the long-running litigation between the bands and the Crown. However, since it deals with the highly contentious money management issue, it is possible that the remainder of the litigation will have reduced significance. The decision follows the Supreme Court of Canada decision in *Authorson v. Canada (Attorney General)*[7] regarding pensions for disabled veterans. Perhaps this decision also reflects the changed economic circumstances of 2009 in which the wisdom of investing in a diversified portfolio is not entirely clear, and the yield offered by long-term government bonds seems increasingly reasonable.

B. *TSUU T'INA NATION V. ALBERTA (ENVIRONMENT)*[8]

1. BACKGROUND

Two Treaty[9] bands sought judicial review of the Alberta Minister of the Environment's recommendation to approve a water management plan and of the decision of the Alberta Crown to approve it.

2. FACTS

The Alberta Crown conducted a review of water management in the South Saskatchewan River Basin (SSRB), including a series of public consultations and studies on water use and

4 *Ermineskin*, *supra* note 1 at para. 19.
5 R.S.C. 1985, c. F-11.
6 *Ermineskin*, *supra* note 1 at paras. 96, 184.
7 2003 SCC 39, [2003] 2 S.C.R. 40.
8 2008 ABQB 547, 96 Alta. L.R. (4th) 65 [*Tsuu T'ina*].
9 See *Treaty*, *supra* note 2; *Treaty No. 7*, Her Majesty the Queen and the Blackfeet and other Indian Tribes, 22 September 1877, online: Early Canadiana Online <http://canadiana.org/record/43117>.

population growth. These efforts resulted in a water management plan being created for the SSRB (the Plan). In 2006, the Minister of Environment recommended that the Plan be approved by the Crown. The Crown approved the Plan by Order in Council 409/2006, dated 30 August 2006.[10]

In 2007, the bands applied for judicial review of the decision and sought declarations that the Crown had a legally enforceable constitutional duty to consult with the bands since their Aboriginal rights, including hunting and fishing rights, were or could be affected by the Plan. Moreover, the bands sought a declaration that the Crown had failed to discharge this duty to consult and had failed in their duty to accommodate Aboriginal rights.

3. DECISION

The chambers judge considered three key Supreme Court of Canada decisions on the duty to consult: *R. v. Sparrow*,[11] *Mikisew Cree First Nation v. Canada (Minister of Canadian Heritage)*,[12] and *Haida Nation v. British Columbia (Minister of Forests)*.[13] He found that these cases represented distinct interplay between the status of the particular right in issue and the timing of the government action. The interplay involved permutations of a right proven or claimed and a government action completed or anticipated.

The chambers judge held that the Crown had conducted adequate consultations and satisfied the requirement for the duty to consult. He declined to find that the duty to consult is a legally enforceable constitutional right and instead viewed previous Supreme Court of Canada decisions to hold that prior consultation is required when existing rights are affected (*Mikisew*), and that this duty is extended to claimed rights (*Haida*). He held that "the duty to consult is part of the evolution of our constitutional common law. Saying it is part of that evolution is quite different than saying it is in the Constitution and I decline to so declare."[14]

4. COMMENTARY

The chambers judge attempted to balance the Crown's duty to consult with its responsibility to manage water supplies:

> In upholding the honour of the Crown, the government is not required to abandon all other interests and duties. The duty for Government to consult with First Nations is not absolute, but rather must be accorded appropriate, albeit substantial, weight when proceeding with government action which adversely affects Aboriginal rights.[15]

Given the pressing need to preserve water supplies in the face of substantial population growth, the Crown must have the ability to balance its responsibilities to all stakeholders.

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10 *Approved Water Management Plan for the South Saskatchewan River Basin (Alberta)*, O.C. 409/2006 (*Water Act*).
11 [1990] 1 S.C.R. 1075.
12 2005 SCC 69, [2005] 3 S.C.R. 388 [*Mikisew*].
13 2004 SCC 73, [2004] 3 S.C.R. 511.
14 *Tsuu T'ina, supra* note 8 at para. 151.
15 *Ibid.* at para. 135.

Given the actions the Crown took to consult with various parties, including these bands, the chambers judge held that it had satisfied its duty to consult.

C. *CANADA (ATTORNEY GENERAL) V. LAMEMAN*[16]

1. BACKGROUND

The plaintiffs, claiming to be descendants of members of an Alberta Indian band, commenced an action against the federal Crown regarding the surrender of a reserve back to the Crown. They claimed that the surrender was wrongful and gave rise to causes of action for breach of fiduciary duty, fraudulent and malicious behaviour, and breach of treaty.

2. FACTS

In 1866, the Chief and some members of the Papaschase Indian band received money in exchange for surrendering treaty rights and rights connected with their reserve. Over the years there were further payments of money paid to other members of the band. In 2001, the plaintiffs commenced this action, claiming that: (1) the members were not properly advised of the consequences of the exchange; (2) the government had wrongfully pressured the band to surrender the reserve; (3) the government had caused dissolution of the band; and (4) the government did not receive market value for the reserve land and had mismanaged the sale proceeds.

The Crown brought a motion for summary judgment alleging the statement of claim failed to raise any genuine issue for trial, that the plaintiffs did not have standing, and that the claims were barred by statutes of limitation.

The chambers judge found that most, but not all, of the claims lacked the factual basis necessary to qualify as triable. The Court of Appeal found most of the issues were genuine, triable issues. The Crown appealed to the Supreme Court of Canada.

3. DECISION

The Supreme Court of Canada, in a unanimous decision, granted the appeal and restored the order of the chambers judge. The Court reviewed the test for summary judgment and found that, even if the claims disclosed triable issues and standing could be established, the claims were barred by the *Limitation of Actions Act*.[17] The Supreme Court of Canada agreed with the chambers judge that the claim must be struck out, except for the claim for an accounting of the proceeds of sale, which is a continuing claim not caught by the *Limitations of Actions Act*.[18]

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16 2008 SCC 14, [2008] 1 S.C.R. 372 [*Lameman*].

17 R.S.A. 1980, c. L-15 (s. 13 of the *Limitations Act*, S.A. 1996, c. L-15.1 states: "An action brought on or after March 1, 1999 by an aboriginal people against the Crown based on a breach of fiduciary duty alleged to be owed by the Crown to those people is governed by the law on limitation of actions as if the *Limitation of Actions Act*, R.S.A. 1980 c. L-15, had not been repealed and this Act were not in force").

18 *Lameman*, *supra* note 16 at para. 12.

The Supreme Court of Canada noted that the evidence established that the causes of action would have been clear to the plaintiffs, exercising due diligence, in the 1970s. The only available inference is that these causes became discoverable in the 1970s and are now statute-barred.[19]

4. COMMENTARY

This decision allows the action to continue regarding an accounting for proceeds from the sale of the reserve lands, provided that the government still possesses these funds and that a plaintiff can demonstrate standing to bring this action. It reinforces the availability of the summary judgment motion in actions related to Aboriginal rights and, more generally, notes that a motion for summary judgment must be judged on the basis of the pleadings and materials actually before the judge, rather than on suppositions about what might be pleaded or proved in the future.[20]

II. ADMINISTRATIVE LAW

A. *ATCO MIDSTREAM LTD. V. ENERGY RESOURCES CONSERVATION BOARD*[21]

1. BACKGROUND

Two companies that would be economically affected by a licence amendment proposed by a third company attempted to obtain standing before the Energy Resources Conservation Board (ERCB) to object to the amendment application. They were unsuccessful and joined the long list of parties, including various first nation and environmental groups, who have been denied standing before the ERCB.

2. FACTS

An operator of a field gas plant applied to the ERCB for an amendment to its licence to allow it to extract ethane from raw natural gas.

The owner of two straddle plants, which extract ethane from gas downstream from field plants, and a party who purchases ethane from field plants and straddle plants in the area applied for standing before the ERCB to contest the field plant operator's application. According to the *Energy Resources Conservation Act*, to obtain standing these parties had to show that they had a legally recognized interest that was adversely affected by the application.[22] The straddle plant owner argued that the approval of the licence amendment would result in a leaner ethane stream reaching its plants, thereby increasing its costs and reducing its revenue stream. The ethane purchaser argued that the amendment would reduce the productivity of certain ethane extraction facilities in the area, thereby increasing the cost of ethane to purchasers such as itself. The parties submitted that these issues raised matters of public interest that deserved to be heard and considered. The ERCB characterized the

19 *Ibid.* at para. 18.
20 *Ibid.*
21 2009 ABCA 41, 446 A.R. 326 [*ATCO*].
22 *Energy Resources Conservation Act*, R.S.A. 2000, c. E-10, s. 26(2).

arguments as "asserting a right to be economically protected from upstream ethane recovery"[23] and concluded that such a right was not a "legally recognized right" within the meaning of s. 26(2) of the *Energy Resources Conservation Act*.[24] It refused to grant standing.

3. DECISION

The Court of Appeal made short work of the decision in 13 paragraphs (as opposed to the 39 paragraphs it took to grant leave).[25] It held that the ERCB's characterization of the straddle plant and purchaser's arguments as asserting economic rights was, at best, a determination of mixed fact and law for which there was no appeal unless there was an extricable error of law or jurisdiction. It held there was no "authority for the proposition that the economic interests asserted are legally recognized rights"[26] (and presumably the Court was unwilling to create such authority). It dismissed the appeals.

4. COMMENTARY

It remains very difficult to obtain standing before the ERCB under s. 26(2) of the *Energy Resources Conservation Act* unless ownership rights are affected. The ERCB and the courts continue to take a narrow view of standing before the ERCB, now holding that mere economic interests are not sufficient.

B. *PROVIDENT ENERGY LTD. V. ALBERTA (UTILITIES COMMISSION)*[27]

1. BACKGROUND

What is the test for obtaining leave to intervene in a leave to appeal application? The *Alberta Rules of Court* are silent.

2. FACTS

A pipeline company, Nova Gas Transmission Ltd. (NGTL), brought an application before the ERCB seeking a construction permit to allow it to construct some pipeline segments and related compressor stations. A second pipeline company, TransCanada Pipelines Limited, brought an application before the National Energy Board (NEB) arguing the relevant pipeline was within the federal jurisdiction of the NEB, not the provincial jurisdiction of the ERCB. An energy company, Provident Energy Limited (Provident), then brought an application before the ERCB arguing NGTL's application should not be heard since it was ultra vires the provincial jurisdiction of the ERCB, or, at a minimum, a stay should be granted until the NEB had ruled on the issue. The ERCB denied Provident's application on the grounds that it did not have jurisdiction to decide constitutional questions. Provident brought an application for leave to appeal the ERCB's decision to the Court of Appeal. Several other

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23 *ATCO*, *supra* note 21 at para. 9.
24 *Ibid.*
25 *ATCO Midstream Ltd. v. Energy Resources Conservation Board*, 2008 ABCA 231, [2008] A.W.L.D. 2878.
26 *ATCO*, *supra* note 21 at para. 11.
27 2008 ABCA 316, [2008] A.W.L.D. 4463.

parties, including the Canadian Association of Petroleum Producers (CAPP), a prominent industry organization, sought leave to intervene in Provident's leave application.

3. DECISION

The Court of Appeal noted that it did not have any rules regarding when it would grant leave to intervene in an application for leave to appeal. It decided to adopt the Supreme Court of Canada's practice to allow such leave rarely and only in "very exceptional circumstances."[28] In this case, it denied leave on the grounds that the parties did not demonstrate any special expertise on the issue nor any unique or different perspective from that already represented on the leave to appeal application.[29]

4. COMMENTARY

Considering that even CAPP was held not to have demonstrated "special expertise," it would seem that parties wanting to intervene in an appeal should wait to apply for leave until if and when leave to appeal is granted. A party faces an uphill battle to obtain leave to intervene at the leave to appeal stage.

III. CONTRACTS

A. *MARATHON CANADA LTD. V. ENRON CANADA CORP.*[30]

1. BACKGROUND

The stakes are often high when the party that is "out of the money" tries to terminate a large natural gas supply contract. Here, that party saw an opportunity to terminate, took the gamble, and won.

2. FACTS

A natural gas purchase agreement allowed the seller to terminate the agreement upon a minimum of two business days notice if a "Triggering Event of Material Adverse Change" occurred. A "Triggering Event" occurred if, in the reasonable opinion of the notifying party, a "Material Adverse Change" existed. A "Material Adverse Change" existed if the Standard and Poor's credit rating for certain long-term debts of the buyer's indirect parent was downgraded below BBB-.[31]

The seller concluded that the credit rating of the buyer's indirect parent (Enron Corp.) had been sufficiently downgraded to trigger a Material Adverse Change, and accordingly, gave two days notice of termination to the buyer. When the buyer failed to pay for the last month's delivery of gas, the seller sued the buyer for approximately $560,000. The buyer counterclaimed for over $126 million, arguing that no Material Adverse Change had occurred

28 *Ibid.* at para. 8.
29 *Ibid.* at para. 9.
30 2009 ABCA 31, 448 A.R. 245.
31 *Ibid.* at paras. 7-8.

and if one had occurred, more than two days notice was required to allow the buyer to remedy the situation.

3. DECISION

The Court of Appeal upheld the trial judge's decision that the seller had reasonable grounds for its opinion that a Material Adverse Change had occurred and that only two days notice of termination was required.[32]

Regarding the grounds for termination, the Court of Appeal noted that the buyer's own president admitted in a letter, issued within days of the Notice of Termination, that the credit downgrade had constituted a Material Adverse Change for many of its trading contracts. Further, there was expert evidence to the effect that Enron Corp's credit rating had dropped below BBB-.

As to the need for more than two days notice, the buyer argued that the termination provisions should not be read to have a "hair trigger."[33] Rather, the buyer urged, the termination provisions should be informed by industry practice and commercial context, or by the imposition of a duty of good faith, to either give the buyer more time to remedy the diminished credit rating, or at least to give sufficient time to obtain a letter of credit to protect the seller in place of the credit worthiness of the buyer's indirect parent. The Court of Appeal rejected the arguments and found that the termination provision plainly specified that two business days notice for termination was adequate. As such, there was no obligation to provide more notice.

Regarding the good faith argument, the Court of Appeal noted that the trial judge did not make any finding of fact that the buyer was a vulnerable party, or that the seller took unfair opportunistic advantage for a disingenuous motive, nor did the seller otherwise run roughshod over any reasonable contractual expectations, and, accordingly, there was no need to address the good faith issue on appeal.[34]

4. COMMENTARY

The case confirms that the courts are not inclined to relieve sophisticated parties from their explicit bargain, even when the bargain contains a "hair trigger" event of default that could cost a party $126 million. Interestingly, the Court was willing to brush aside the good faith and reasonable expectation concerns raised by the buyer, notwithstanding that the seller was seeking to terminate a seriously "out of the money" long-term supply contract by relying on a relatively technical breach (there was apparently evidence that the buyer itself was solvent) and the seller had a discretion under the termination provision to choose a longer notice period, but chose instead to impose the minimum notice period possible. There may have been room here for the Court to have rescued the buyer, but it did not; the explicit terms of the contract governed.

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32 *Ibid.* at para. 11.
33 *Ibid.* at para. 13.
34 *Ibid.* at para. 19.

B. *CARGILL GAS MARKETING LTD. V. ALBERTA NORTHEAST GAS LTD.*[35]

1. BACKGROUND

The seller under a long-term gas supply contract believed it had found a mistake in its price calculations and attempted to collect the underpayment from the buyer for as many years as the applicable limitation period would allow. Nearly $100 million was at stake.

2. FACTS

The contract called for gas to be delivered by volume (Mcf) but priced, in part, by heat content (MMBtu). The heat content of a volume of gas depends, among other things, on the amount of water contained in the gas. If the heat content is calculated as if the gas is saturated with water (that is, "wet conversion"), it will have approximately 1.7 percent less heating value than if the heat content is calculated as if the gas did not contain water (that is, a "dry conversion"). Historically, the parties had always used a wet gas conversion to derive the price, but when the seller changed hands, the new seller reasoned that the gas was, in fact, always delivered "dry," so its price should be calculated dry.[36]

3. DECISION

The trial judge found that the contracts unambiguously provided for the price to be based on wet gas and that no error had been made. He noted that a wet conversion factor had been in common use in the industry at the time, notwithstanding that the gas was delivered dry. Further, the parties had used a wet conversion for 13 years without complaint until the new seller became involved.[37] The action was dismissed.

4. COMMENTARY

The case emphasizes the importance of contractual drafting and the need to remain vigilant over boilerplate clauses. Even though the interpretation urged by the seller made a certain amount of common sense — dry gas should be measured dry — it required the language of the contracts to be stretched farther than the trial judge was willing to allow. He found that the contracts clearly said that the gas was to be measured as if wet, so there had been no error in determining a wet gas-based price. The case is also another example this year of an Alberta court's lack of sympathy for a party relying on a newly found error to reverse years of past practice.

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35 2008 ABQB 59, [2008] A.W.L.D. 2742 [*Cargill*].
36 *Ibid.* at paras. 8-9.
37 *Ibid.* at paras. 26, 30, 37.

C. *WICKSTROM V. WETTER*[38]

1. BACKGROUND

Gross royalty trusts have spawned much litigation, particularly with respect to whether they apply to future oil and gas leases or expire with the lease in existence when the trust was created. A practice has developed whereby an application can be made in chambers to have a royalty trust terminated and the consequent termination order served on the various royalty unit holders who are then given time to object. In many cases, no unit holder objects, resulting in a relatively cost-effective way to quiet the mineral title. However, in this case, some royalty unit holders objected, and despite case law solidly against them, managed to survive summary judgment and push the matter to trial.

2. FACTS

The owners of the mineral interests in a parcel of land brought proceedings to have a 1951 gross royalty trust declared expired and a caveat removed from their mineral title. The gross royalty trust agreement (GRTA) contained identical language to that considered by the Court of Appeal in *Guaranty Trust Co. of Alberta v. Hetherington*,[39] which found that the trust had expired. The chambers judge granted the customary order, which allowed any unit holder in the royalty trust to apply to set aside the order within 45 days of service. Certain unit holders applied to set aside the order. The mineral owners brought a summary judgment application against the unit holders on the grounds that the GRTA was identical to that considered in *Hetherington* and, accordingly, came to an end when the then existing Imperial Oil lease terminated due to a lack of production in 1967. The mineral owners had leased their oil and gas rights to a new oil company in 1994, and did not want to share their royalties with the unit holders. The unit holders resisted summary judgment on the ground that the GRTA had always been intended to apply to future oil and gas leases. They sought rectification of the GRTA to reflect that intention.

3. DECISION

The chambers judge refused summary judgment. He traced the evolution of royalty trust law from *Hetherington* to *Scurry-Rainbow Oil Ltd. v. Kasha*,[40] which held that the terms of the royalty trust agreement in that case did apply to future leases, to *Scurry-Rainbow Oil Ltd. v. Galloway Estate*,[41] in which Hunt J. (as she then was) held that the royalty trust agreement in that case also applied to future leases, and finally, he arrived at *Barrett v. Krebs*,[42] in which the Court of Appeal refused to reconsider *Hetherington*, holding, in effect, that the issue of whether the gross royalty trust applies to future leases is "at bottom" a finding of fact about the true intent of the parties, and that while *Hetherington* has substantial precedential force,

38 2008 ABQB 83, [2008] A.J. No. 435 (QL).
39 (1989), 95 A.R. 261 (C.A.) [*Hetherington*].
40 (1993), 143 A.R. 308 (Q.B).
41 (1993), 138 A.R. 321 (Q.B.).
42 (1995), 174 A.R. 59 (C.A.).

it "can be distinguished by a trial judge who hears new evidence of a commanding nature to the opposite effect."[43]

In this case, the chambers judge was presented with affidavit evidence that the original signatories to the gross royalty trust, now long deceased, had always said that they intended their children to benefit from the gross royalty trust units in the future. This evidence, largely based on hearsay, was held by the chambers judge to provide sufficient evidence to resist summary judgment.[44]

4. COMMENTARY

The gross royalty trust saga continues. It is now possible to resist a summary judgment application using relatively scant evidence that the original signatories to the royalty trust agreement had always meant the royalty trust to apply to future leases, notwithstanding the language they chose in the gross royalty trust agreement and notwithstanding that all the original signatories are now deceased. The chances of obtaining an efficient, inexpensive quieting of the mineral title have decreased considerably.

D. *SEMCAMS ULC V. EXXONMOBIL CANADA ENERGY*[45]

1. BACKGROUND

One of the owners of a gas gathering system saw an opportunity to monetize its excess transportation capacity by acting as a "midstreamer." The operator of the system attempted to stop any midstreaming because it would take the associated fee-generating business away from the system. The midstreamer prevailed.

2. FACTS

A gas gathering system was governed by an agreement for its construction, ownership, and operation (COO Agreement). Under the COO Agreement, the owners of the system were allowed to transport their own gas free of charge up to a certain allocated capacity. Non-owners had to pay a fee to use the gas gathering system. The profits from the non-owners gathering fees were shared among the owners of the gas gathering system.

One day, one of the owners realized it was not using all of its allocated capacity, so it decided to purchase gas produced from a non-owner and transport that gas over the gathering system at no additional fee so that the gas could be sold at a higher price elsewhere. The arrangement meant the other owners of the gathering system lost the fees that would otherwise have been derived from transporting the non-owner's gas, but the owner in question made a profit by acting as a midstreamer.

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43 *Ibid.* at para. 21.
44 *Ibid.* at paras. 112-13.
45 2008 ABQB 469, [2008] A.J. No. 826 (QL).

When the operator of the gas gathering system became aware of what the other owner was proposing, it maintained that the COO Agreement was never intended to allow midstreamers to transport gas and refused to carry the gas. Litigation ensued. The midstreaming owner brought an application for a declaration that it was entitled to have the gas purchased from a non-owner transported free of charge on the gas gathering system.

3. DECISION

The chambers judge held that midstreaming was allowed. He noted that the COO Agreement provided that: "Each Owner shall have the right to use … the Capacity … equal to its respective … Participation … for the transportation of its Gas."[46] "[I]ts Gas" meant, plainly, the gas of each owner. "Gas" was defined to mean in substance natural gas before it has been subjected to any processing except water removal, whether from wells within the designated area owned by an owner of the gathering system or not.[47] Since the midstreaming owner bought and owned the gas from the well owner, and since the gas was bought at the wellhead before it had been subjected to any processing other than water removal, the chambers judge held it qualified as "Gas" and could be transported free of charge.[48]

4. COMMENTARY

The operator contended that it was never the intention of the parties who drafted the original gas gathering agreement to permit midstreaming, as midstreaming was not common at the time. However, the language used by the COO Agreement was broad enough to permit midstreaming, at least in the provision most clearly addressing the use the owners could make of the gathering system. The chambers judge glossed over the warranty provision in the COO Agreement, which provided that "[e]ach Owner warrants that it has the right to produce and deliver to the Gathering System, its portion of the Gas."[49] That passage certainly appears to contemplate that any gas delivered by an owner to the system will be produced by it, and so, arguably, introduces some ambiguity as to whether midstreaming is allowed since a midstreamer does not produce the gas it delivered to the system, rather, it buys the gas from the person who produces it. However, the extraneous evidence introduced to address any ambiguity appeared only to indicate that the parties to the agreement never contemplated whether midstreaming would be allowed. That sort of evidence falls short of demonstrating that the parties intended to disallow midstreaming. Under the language chosen by the parties in the provision that squarely addressed the use owners could make of the gathering system there appears little doubt that midstreaming was permitted.

46 *Ibid.* at para. 69 [emphasis omitted].
47 *Ibid.* at para. 67.
48 *Ibid.* at para. 72.
49 *Ibid.* at para. 47.

IV. ENVIRONMENTAL LAW

A. *GRAFF V. ALBERTA (ENERGY & UTILITIES BOARD)*[50]

1. BACKGROUND

The case discusses the need for medical evidence in order to demonstrate special health sensitivities if one is opposing the drilling of sour or sweet gas wells near a residence.

2. FACTS

An energy company applied to the Alberta Energy Utilities Board (AEUB) for licences to drill gas wells. One of the licences was for sour gas and one was for sweet gas. Each well was to be located in the vicinity of the homes of private citizens. The private citizens objected to the issuance of the licences on the grounds that they suffered from pre-existing health conditions, making them sensitive to chemicals, and that the consequent resource extraction near their home would directly and adversely affect them. The private citizens did not provide medical evidence of their pre-existing health conditions. The AEUB dismissed their objections and granted the licences. The private citizens eventually obtained leave to appeal the grant of the licences on the ground, roughly, that the AEUB erred by not affording them a proper opportunity to be heard and by consequently concluding that they were not directly and adversely affected.

3. DECISION

The Court of Appeal upheld the AEUB's decision. One must do more than merely assert a sensitivity; there must be medical proof.[51]

4. COMMENTARY

Something more than a mere assertion is required to demonstrate that one is directly and adversely affected by an AEUB matter. One has to provide some proof and be mindful that such proof, even if it is medical in nature, will go on the public record unless a specific confidentiality order is obtained.

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[50] 2008 ABCA 119, 166 A.C.W.S. (3d) 615.
[51] *Ibid.* at paras. 20-23.

V. UNIT AGREEMENTS

A. *SIGNALTA RESOURCES LTD. V. DOMINION EXPLORATION CANADA LTD.*[52]

1. BACKGROUND

A prolific gas well was producing from a formation in an area associated with a unit agreement. The well owner maintained that the formation was not included in the unit; the unit operator disagreed.

2. FACTS

The operator of a gas unit argued that a well producing from the Glauconite formation was producing unit gas and should be included within the unit. The well owner maintained that the Glauconite formation had never been contributed to the unit, so was not unitized.[53]

3. DECISION

The well owner won. The Court of Appeal upheld the trial judge's decision that the working interest in the Glauconite formation had never been contributed to the unit. The case largely turned on its facts. Of general interest, however, is the holding with respect to the implications of the well owner having signed the unit agreement as a royalty interest owner. The unit operator argued that by signing the unit agreement as a royalty holder in certain non-Glauconite formations, the well owner was deemed to have contributed all its interests to the unit, including its working interests in the Glauconite formation. Reference was made to clause 1302 of the unit agreement, which provided: "If a Party owns a Working Interest and a Royalty Interest, its execution of this agreement shall constitute execution in both capacities."[54] Since the well owner had a working interest in the Glauconite formation at the time it signed the unit agreement as a royalty holder, the unit operator argued it must be taken to have contributed the Glauconite formation to the unit.

The Court of Appeal refused to apply cl. 1302 "in this literal fashion."[55] It held that it is implicit in the wording of such a clause that "it applies only to the working interests and royalty interests intended to be committed and bound by the agreement."[56] The clause is intended as a matter of convenience only, so that a party does not have to sign the agreement multiple times for each type of interest it would otherwise be contributing to the unit.

The case was complicated by numerous historical errors made in the tract and unit participation schedule of the unit agreement. For the approximate 30-year life of the unit, the Glauconite formation was sometimes included in the schedule, and sometimes not. On the facts, both Courts found that it ought not to have been included. However, the clause in the unit agreement that deemed the schedule to be true until changed certainly appears to have

52 2008 ABCA 437, [2008] A.J. No. 1441 (QL).
53 *Ibid.* at para. 2.
54 *Ibid.* at para. 37.
55 *Ibid.* at para. 40.
56 *Ibid.* at para. 41.

been treated seriously by the Court of Appeal. The Court repeatedly refers to the fact that at the time the well in question was drilled, the schedule did not include the Glauconite formation (although it had previously done so), and further, at the time the unit operator became a party to the unit agreement, the schedule similarly did not include the Glauconite formation. It was only after the well was drilled and the well owner asked to have the gas processed at the unit gas plant that the prospect of the well being a unit well was raised, and then litigated.

4. COMMENTARY

The case considers some common unit agreement provisions and demonstrates that the courts will give the various clauses, including the deeming clauses, serious consideration when reading the agreement as a whole. It also demonstrates, like a few other cases this year, that the courts are not very sympathetic to a party who is trying to impose a new interpretation on an old agreement.

VI. RIGHTS OF FIRST REFUSAL

A. *CANADIAN NATURAL RESOURCES LTD. V. ENCANA OIL & GAS PARTNERSHIP*[57]

1. BACKGROUND

Two sophisticated parties with experienced counsel brought summary applications to have a provision of the *1990 CAPL Operating Procedure*[58] interpreted in order to resolve a dispute between them. Evidence was kept to a minimum. There was no extrinsic evidence called and no expert testimony: just a lean case for an expeditious and efficient resolution of a dispute. What could go wrong?

2. FACTS

At issue was the application of the right of first refusal (ROFR) clause contained in the *1990 CAPL*, which formed part of a pooling agreement. In particular, the question was when the ROFR was triggered in a farmout situation. Does the ROFR arise when the decision to enter into the farmout agreement is made? Or is it triggered only after the third party purchaser under the farmout has selected the well sites that it intends to drill and earn? At first instance, it was held that the ROFR was not triggered until the actual well sites had been determined by the third party farmee.[59] The matter was appealed to the Court of Appeal.

3. DECISION

A majority of the Court of Appeal found that the applicable provision of the *1990 CAPL*, cl. 2401, was ambiguous, and refused to decide the case without a full evidentiary record and

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[57] 2008 ABCA 267, 440 A.R. 338 [*Canadian Natural Resources*].

[58] *1990 CAPL Operating Procedure* (Calgary: Canadian Association of Petroleum Landmen, 1990) [*1990 CAPL*].

[59] *Canadian Natural Resources*, *supra* note 57 at para. 15.

expert testimony since, at least in part, the contract at issue was the industry standard agreement. The majority went so far as to encourage a future trial judge to appoint an expert for the court in the event the parties did not lead expert evidence on their own. The decision of the court below was vacated and a trial directed.[60]

The dissenting Justice on the Court of Appeal was prepared to decide the case on the evidence and arguments adduced by the parties. He reasoned that it was up to the parties to decide whether to proceed summarily or not. Given the views of the majority, however, he declined to give his substantive views on the case.[61]

4. COMMENTARY

No doubt counsel involved thought they were doing their clients a favour in proceeding in a summary fashion with a minimum of expert evidence and an efficient case. The majority of the Court of Appeal disagreed and directed a full trial with expert evidence, including all the bells and whistles. The case has implications for litigation counsel who might be best advised to proceed with a full, expensive expert case if the interpretation of an industry standard agreement is involved, rather than discovering, a year after the summary case was originally heard, that the Court of Appeal wants a full trial. No doubt a final judicial resolution of this case is at least two more years away. So much for the lean, expeditious case.

VII. SURFACE RIGHTS

A. *ENCANA CORP. V. CAMPBELL*[62]

1. BACKGROUND

The Surface Rights Board (SRB) imposed more stringent environmental conditions on an entry order than the ERCB imposed on the related drilling licence. The Court of Queen's Bench upheld the SRB's order, ruling that it was not inconsistent with the ERCB's licence since it was possible to comply with both.

2. FACTS

A landowner and an oil company agreed on a surface lease for an oil well. The lease contained more stringent conditions than the ERCB would normally impose on a well licence. Among other things, it required testing of the groundwater for hydrocarbon contamination whether or not coal bed methane drilling was intended to be pursued. Eventually, the oil company transferred its well licence to EnCana Corporation (EnCana). EnCana had the licence transfer approved by the ERCB and then approached the landowner to transfer the corresponding surface lease to it. The landowner refused to consent to the assignment unless EnCana agreed to a certain interpretation of the hydrocarbon testing

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60 *Ibid.* at para. 29.
61 *Ibid.* at paras. 41-42.
62 2008 ABQB 234, 167 A.C.W.S. (3d) 437 [*EnCana*].

condition, which EnCana was not willing to do (EnCana only wanted to conduct water testing if it decided to pursue coal bed methane).

With no agreement having been achieved regarding the assignment of the surface lease, EnCana applied to the SRB for a right of entry order. The SRB granted the entry order, but attached conditions that virtually replicated the conditions on the old surface lease, including the landowner's interpretation of the water testing provision. EnCana appealed to the Court of Queen's Bench for an order quashing the conditions on the ground that the SRB exceeded its jurisdiction.

3. DECISION

The Court of Queen's Bench Justice, in an early post-*Dunsmuir v. New Brunswik*[63] case, held that the standard of review applicable to the decision of the SRB imposing conditions on its order was reasonableness.[64]

Regarding the substance of the case, s. 15(6) of the *Surface Rights Act* provides that the SRB has the right to make its entry order subject to "any conditions it considers appropriate."[65] However, the SRB must "ensure that the right of entry order is not inconsistent with the [ERCB] license, permit or other approval."[66]

EnCana argued the conditions were unreasonable and in excess of the SRB's jurisdiction since the conditions were more stringent than those the ERCB would have applied. EnCana argued it could fully comply with its ERCB license yet still not fulfill the SRB entry conditions and thus, the SRB conditions were inconsistent with its well licence. The Court of Queen's Bench disagreed, citing *Smith v. The Queen*,[67] and held that a right of entry order issued by the SRB will only be considered inconsistent with a licence issued by the ERCB when compliance with the entry order would involve a breach of the licence. Since the conditions imposed by the SRB were merely more stringent than the ERCB licence, EnCana could fully comply with both the SRB entry order and the well licence, and therefore they were not inconsistent.[68]

4. COMMENTARY

In this case, the SRB showed a willingness to impose more stringent environmental controls than the ERCB. Specifically, the conditions at issue related to: chemical applications; soil sterilization materials; pesticides; herbicides; the disposal of drilling fluids; the handling of toxic chemicals, hazardous substances, and radioactive material; the need to create a berm to contain the migration of hydrocarbons, drilling fluids, and chemicals; as well as hydrocarbon water tests and reports. Given that the development of coal bed methane seemed to lurk in the background, this could be an indication that some of the environmental

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63 2008 SCC 9, [2008] 1 S.C.R. 190 [*Dunsmuir*].
64 *EnCana*, *supra* note 62 at para. 18.
65 R.S.A. 2000, c. S-24, s. 15(6)(b).
66 *Ibid.*, s. 15(6).
67 [1960] S.C.R. 776.
68 *EnCana*, *supra* note 62 at para. 34.

issues to be addressed in that sphere will play out in front of the SRB, with the courts only reviewing such decisions on the basis of reasonableness.

B. *CANADIAN NATURAL RESOURCES LTD. V. BENNETT & BENNETT HOLDINGS LTD.*[69]

1. BACKGROUND

For many years the SRB primarily used the "pattern of dealings" method to determine the annual rate of compensation payable for a surface lease. The pattern of dealings method examined the other compensation "dealings" in an area in an attempt to arrive at a type of proxy for the fair market value of compensation for the type of land at issue. In 1978, the Court of Appeal in *Livingston v. Siebens Oil & Gas Ltd.* determined that if a pattern of dealings could be established, "the Board should only depart from such compensation with the most cogent reasons."[70] In this case, the SRB departed from the pattern of dealings standard and that departure was upheld on appeal to the Court of Queen's Bench.

2. FACTS

An oil and gas company appealed a compensation decision of the SRB to the Court of Queen's Bench. Before the SRB, the company had advocated for the use of the pattern of dealings method to determine the appropriate compensation to be paid to the farmers for the compulsory use of their land for oil and gas development. The SRB appeared to reject that method, without providing reasons, as it awarded a higher level of compensation than advocated by the company.

3. DECISION

The Queen's Bench Justice first reasoned that the decision of the SRB was reviewable on a standard of reasonableness, notwithstanding the absence of reasons.[71] He then noted that two general approaches have developed to attempt to quantify the compensation payable: the "pattern of dealings" approach and the "actual loss of use and adverse effect" approach.[72]

With respect to the pattern of dealing approach, the judge held that the evidence was too deficient to establish the requisite pattern. Specifically, the judge took a relatively technical approach to the report of the company and noted a litany of deficiencies, including that: the area to which the pattern was applied was not defined; there was no information as to the total number of sites that existed in the area from which the report sampled values; there was no explanation of why the particular pattern advocated was applicable to the specific leases in question; and there was no explanation as to why some leases were presented as comparables when they did not appear to fit the pattern advocated.

[69] 2008 ABQB 19, 436 A.R. 256 [*Bennett*], leave to appeal to C.A. granted, 2008 ABCA 440, 75 R.P.R. (4th) 7 [*Bennett*, Appeal].
[70] (1978), 8 A.R. 439 at 445 (S.C. (A.D.)).
[71] *Bennett*, *supra* note 69 at para. 10.
[72] *Ibid.* at paras. 42-43.

Having found that there was insufficient evidence to establish a pattern, the judge turned to the actual loss of use and adverse effect approach. He ultimately found that the evidence sufficiently supported the SRB's determined values so as to render that approach and the SRB's decision reasonable. Nominal adjustments were made to some of the SRB's values, but substantively the SRB's values were confirmed.

The company sought leave to appeal to the Court of Appeal. On the leave application, the Appellate Justice followed the Supreme Court of Canada's decision in *Dunsmuir*[73] and confirmed that the applicable standard of review for a decision of the SRB remains reasonableness. Leave was granted on the issues of whether the chambers judge misconstrued the test for determining whether a "pattern of dealings" existed, as well as whether the chambers judge erred in rejecting the expert testimony at the hearing before him.[74]

4. COMMENTARY

In this case, and *ConocoPhillips Canada Resources Corp. v. Lemay*,[75] considered below, the SRB and the Courts appear to be moving away from the pattern of dealings approach and towards a more specific fact-based approach to compensation. Whether the Court of Appeal will encourage this movement, or arrest it, remains to be seen. In any event, until the Court of Appeal decides the issue, it would be prudent to ensure that any pattern of dealings report is rigorously and diligently prepared — otherwise there is a definite risk that the pattern of dealings approach will not be followed.

C. *CONOCOPHILLIPS CANADA RESOURCES CORP. V. LEMAY*

1. BACKGROUND

This is another case in which the pattern of dealings method for determining compensation was replaced by a consideration of the actual data on the loss. New technological advances in GPS tracking and computer programming appear to have swayed the SRB and Court of Queen's Bench away from the pattern of dealings method.

2. FACTS

ConocoPhillips Canada Resources Corp. appealed to the Court of Queen's Bench from the decisions of the SRB with respect to two surface leases. The company argued the SRB erred in refusing to grant it a proper adjournment when it was caught by surprise by the submissions of farmers respecting compensation for the adverse effect of two well sites. The company had been negotiating with the farmers based on the pattern of dealings approach, and it was caught by surprise at the hearing when the farmers advocated the use of an actual loss of use and adverse effect approach. The company urged the Court to use the pattern of dealings approach instead.

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73 *Dunsmuir*, *supra* note 63.
74 *Bennett*, Appeal, *supra* note 69 at paras. 9-10.
75 2009 ABQB 72, [2009] A.J. No. 89 (QL).

3. DECISION

The Queen's Bench Justice held that the SRB erred in failing to grant the proper adjournment. Accordingly, there was a breach of natural justice compelling the Court, under the applicable statute, to deal with the matter by way of a new hearing, notwithstanding the Court's own preference to send the matter back to the SRB. The judge speculated that given the error involved, a judicial review application might have been possible, which would have avoided the appeal provisions, allowing the Court to return the matter back the SRB.[76] However, since the matter arose on appeal, the judge had little choice but to proceed with the hearing.

He next considered the degree of deference, if any, owed to the SRB given that the appeal was *de novo*. The judge decided, following *Dunsmuir*, that the applicable standard of review remained reasonableness.[77]

Ultimately, the judge agreed with the SRB's decision to calculate the claim for adverse effect based on the specific empirical data rather than on the pattern of dealings approach. In considering the evidence, he reduced the compensation ordered by the SRB somewhat, but agreed with the methodology. The usual solicitor-client costs were awarded to the farmers as well as 40 percent of the claim for the time of the farmers, as the costs were "considerably less than any expert would have charged."[78]

4. COMMENTARY

Both the SRB and the Court preferred the actual empirical data of the farmers relating to their farming methods to estimate the appropriate compensation rather than the use of the pattern of dealing approach. The extent of the evidence presented, which included GPS-based field tracking technology, appeared to have influenced the decision. As noted by the chambers judge,[79] technological advances and new computer programs are providing new ways to measure the appropriate compensation on an individual basis. It remains to be seen if these advances will displace the need and use for the pattern of dealings methodology in the future.

VIII. TAXATION

A. *CANADA V. MCLARTY*[80]

1. BACKGROUND

The Supreme Court of Canada examined the concepts of absolute and contingent liability and arm's-length transactions as they relate to income tax deductions for Canadian exploration expenses.

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76 *Ibid.* at paras. 36-38.
77 *Ibid.* at para. 63.
78 *Ibid.* at para. 240.
79 *Ibid.* at para. 180.
80 2008 SCC 26, [2008] 2 S.C.R. 79 [*McLarty*].

2. FACTS

A taxpayer purchased an interest in proprietary seismic data as a participant in an oil and gas venture. The interest was acquired for $100,000, paid for by way of $15,000 cash and an interest-bearing promissory note of $85,000.[81] The principal and interest were to be paid from a percentage of the cash proceeds from any future sales or licensing of the seismic data, as well as from a percentage of the revenue generated from the drilling program of the joint venture. The promissory note provided that should any principal or interest remain unpaid at the maturity of the note, a trustee was to be appointed to sell the seismic data and apply a portion of the proceeds to satisfy the amounts owing. The taxpayer treated the purchase as a Canadian exploration expense, and added $100,000 to his cumulative Canadian exploration expense pool. Accordingly, he deducted $81,655 as a Canadian exploration expense in year one, and an additional $14,854 in the next year. The Minister reassessed the taxpayer on the basis that the seismic data had a fair value of $32,182, not $100,000.[82] Litigation ensued. The Tax Court found that the taxpayer was entitled to add the full $100,000 to his expense pool. The Federal Court of Appeal set aside the decision, concluding that the taxpayer was not dealing with the vendor at arm's-length and remitted the matter back to the Tax Court to determine the fair market value of the seismic data. The matter was further appealed to the Supreme Court of Canada.

3. DECISION

The majority of the Supreme Court of Canada decided that the trial judge's decision should be restored. The majority held that under s. 66.1(6) of the *Income Tax Act*[83] a taxpayer may take a deduction where he has incurred an expense, and generally, a taxpayer incurs an expense when he has an obligation to pay a sum of money. The taxpayer had a legal obligation to pay the sum of money when he paid the $15,000 in cash and executed a promissory note for the remainder. The promissory note was not a contingent liability, since its existence did not depend upon an event which may or may not happen. The liability was immediate and was independent of whether there were future sales or licensing revenues, or future production cash flow from the drilling program. In essence, the promissory note represented a limited recourse debt, and a creditor's limited recourse on default of a debt cannot make an otherwise absolute liability into a contingent liability. With respect to the arm's-length finding, the trial judge applied the relevant indicia for identifying whether the dealings were at arm's-length, and found on the facts that the dealings were arm's-length. In the absence of palpable and overriding error, the Supreme Court of Canada ruled that the findings of the trial judge should not be overturned on appeal.[84]

The two dissenting judges agreed that the transaction occurred at arm's-length, but characterized the promissory note as a contingent liability given its limited recourse nature, including the fact that the balance owing would be forgiven if the specified percentage of anticipated proceeds were not realized. The dissenters would have found that the taxpayer

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81 *Ibid.* at para. 5.
82 *Ibid.* at para. 8.
83 R.S.C. 1985 (5th Supp.) c. 1.
84 *McLarty, supra* note 80 at para. 71.

could claim a tax deduction if and when he paid amounts under the promissory note, but until then his liability was only contingent.

The majority found that a creditor's limited recourse on the default of a debt cannot make an otherwise absolute liability into a contingent liability.[85] The extent of the recourse has no bearing on the question of whether liability is absolute or contingent. A mere risk to the value of the collateral security at maturity does not transform limited recourse liability into a contingent liability since, if it were so, all such liabilities would be contingent. Further, even in the case of a loan with recourse, there can never be absolute certainty that the full repayment will be made. None of those considerations makes the liability contingent. The majority acknowledged that the taxpayer's collateral security in this case was ultimately sold for only $17,600, of which the percentage attributable to pay the note was $10,500. However, the majority noted that there are other remedies for the Minister where assets are overvalued solely to obtain a tax advantage. There is no need to involve the law of absolute and contingent liabilities.[86]

4. COMMENTARY

A limited recourse promissory note emerges from the case as an attractive vehicle for maximizing Canadian exploration expense deductions.

IX. JOINT OPERATING AGREEMENTS

A. *ADECO EXPLORATION COMPANY LTD. V. HUNT OIL CO. OF CANADA INC.*[87]

1. BACKGROUND

An operator negligently allowed an oil and gas lease to expire. Under the *1990 CAPL*, is that enough to become liable to the non-operators? Or does the operator's error have to be grossly negligent? Is it grossly negligent to allow a lease to expire?

2. FACTS

Three oil companies jointly owned certain Crown oil and gas leases in an oil play in central Alberta. One owned 75 percent, one owned 16.66675 percent, and the third owned 8.3325 percent of the working interest. A royalty owner also held a 3 percent royalty.[88] The three oil companies entered into a Joint Operating Agreement (JOA) based on the *1990 CAPL*. The 75 percent owner, Hunt Oil Company of Canada Inc., became the operator. All of the parties, including the royalty owner, had previously entered into a royalty agreement that was subsequently made applicable to the leases at issue.

The leases each had a primary term of five years and included the right to extend the primary term upon certain obligations being fulfilled. At the end of their primary term, the

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85 *Ibid.* at para. 89.
86 *Ibid.* at para. 34.
87 2008 ABCA 214, 437 A.R. 33 [*Adeco*].
88 *Ibid.* at para. 2.

renewal obligations had been fulfilled and the leases were eligible for renewal. On the final date for renewal, the operator submitted a continuation application to Alberta Energy for the leases. The application was incomplete since, while it enclosed well logs and recent production data, it failed to include a required interpretative map. The interpretative map was needed as the renewal was based on production from offset wells.

Alberta Energy informed the operator of the deficiency, and gave it one month to submit the required information. Upon receiving the letter from Alberta Energy, the operator's land administrator contacted the responsible landman, who may or may not have contacted the geologist involved in order to obtain the additional information. In any event, the landman informed the land administrator that: "we'll have to let them expire — we have no additional information to submit."[89] Accordingly, the operator let the leases expire.

The royalty holder noticed that the terminated parcels were posted for sale by Alberta Energy and immediately made inquiries to determine what happened. Litigation ensued. The two non-operators alleged that the operator breached its contractual duty to keep the leases in good standing, it was negligent in its renewal process, and it breached a fiduciary duty to maintain the leases in good standing. The royalty owner alleged the operator breached the royalty agreement and breached the fiduciary duties it owed to the royalty holder. Against the non-operators, the operator defended on the basis that it met the standard of care contemplated by the JOA and *1990 CAPL*, both on a negligence and gross negligence standard. Regarding the claim by the royalty owner, the operator claimed indemnity from the non-operators under the royalty agreement, which was defended by the non-operators on the basis that the royalty agreement was amended by the JOA, rendering the operator fully responsible to the royalty owner.

3. DECISION

The Court of Appeal held that under the *1990 CAPL*, an operator is only responsible to the non-operators for omissions amounting to gross negligence; mere negligence is not enough.[90]

Nonetheless, the Court had little difficultly in holding that the operator was grossly negligent. It held that obtaining the continuation was a simple matter. The information that was missing was readily available, or could have been produced with minimal effort. The operator should have had employees who knew and understood the continuation process or at least had a system in place that required all rejections to be referred to someone up the management chain who knew what to do. The Court found that the operator's system was largely ad hoc and last minute. The Court was also critical that the operator waited until the last possible day to submit the application, and failed to follow up with Alberta Energy to inquire why its rejection letter was dated 14 days prior to the operator actually receiving it.

89 *Ibid.* at para. 9.
90 *Ibid.* at para. 42.

Regarding the fiduciary duty issue, the Court overturned the trial judgment and found that fiduciary duties cannot be imposed in the circumstances.[91] In particular, there was no evidence that the operator did not act loyally, that it was in a conflict of interest, or that it benefited at all. Its acts, while grossly negligent, were neither intentional nor self-directed.

The result of the trial was upheld and the operator's appeal was dismissed.

4. COMMENTARY

Central to the case are the liability and indemnification clauses of the *1990 CAPL*, cls. 401 and 402. In *Erehwon Exploration Ltd. v. Northstar Energy Corp.*,[92] Hunt J. (as she then was) considered comparable provisions of the *1981 CAPL Operating Procedure*[93] and held that the gross negligence requirement pertained only to third party claims, and not to claims between operator and non-operator.[94] The Court of Appeal has now confirmed that cl. 401 of the *1990 CAPL* clearly and unambiguously makes the operator responsible to non-operators only if its omissions amount to gross negligence. No doubt, the *2007 CAPL Operating Procedure*[95] will be interpreted to the same effect, given that it appears to be more clearly drafted to adopt the gross negligence standard.

The Court further commented that cl. 401 of the *1990 CAPL* does not release the operator from its fiduciary duties, as the clause could have added fiduciary obligations to the list of explicitly excluded duties, but it did not. However, the Court found that fiduciary duties were not owed in this case since the operator's conduct was not willful, only negligent and grossly negligent. The Court emphasized that a breach of fiduciary duty generally involves intentional conduct.[96]

B. *HUSKY OIL OPERATIONS LTD. V. GULF CANADA RESOURCES LTD.*[97]

1. BACKGROUND

An operator, Husky Oil Operations Ltd., had been running an oil battery for 15 years without a written agreement. It realized it had been seriously overcharging itself for certain processing charges and sought to recoup the overcharge from the non-operators. Could it recoup the loss when it was the party that originally proposed that the excessive fee be charged?

2. FACTS

Three oil companies were the joint owners of an oil battery. For 15 years, they financed, built, and operated the battery. They had never signed a contract to govern battery operations. Things went fine until one day, the operator tied six wells into the battery that were almost

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91 *Ibid.* at para. 74.
92 (1993), 147 A.R. 1 (Q.B.) [*Erehwon*].
93 *1981 CAPL Operating Procedure*, (Calgary: Canadian Association of Petroleum Landmen, 1981).
94 *Erehwon*, *supra* note 92 at para. 62.
95 *2007 CAPL Operating Procedure* (Calgary: Canadian Association of Petroleum Landmen, 2007).
96 *Adeco*, *supra* note 87 at para. 69.
97 2008 ABQB 390, 96 Alta. L.R. (4th) 104.

wholly owned by the operator. One of the non-operators inquired how much the operator proposed to charge itself for processing. The operator responded that it was charging rates equivalent to the fees charged for processing trucked in production.

Three years later, the operator realized that the trucked in fee was unfairly high compared to the price that would be charged under a Jumping Pound formula. The operator wrote to the two non-operators proposing to retroactively use a Jumping Pound formula instead of the trucked in fee. One of the non-operators tried to reconcile the operator's numbers, but it did not have sufficient information from the operator and, as a result, erroneously calculated that the proposal would result in a credit to the non-operator of $100,000. Based on that erroneous understanding, the non-operator agreed to the proposal. The other non-operator did not respond to the proposal.

The operator was still not satisfied with its own calculations and wrote to the non-responsive non-operator with some further calculations and refinements based on a Jumping Pound formula. It requested that the non-operator agree to the new method and its calculation by a certain date. If no response was received, the operator would deem the non-operator's silence to be acceptance of the proposal. In fact, further discussions occurred between the operator and this non-operator, but no agreement was reached.

Eventually, the operator notified the two non-operators that the operator's latest calculation "had been approved," and it invoiced one non-operator $865,187.58 and the other $1,315,464.44 to recover the amount the operator believed it overcharged itself for processing fees.[98] Not surprisingly, the two non-operators refused to pay. Litigation ensued.

3. DECISION

Noting that no party called expert evidence on the usual practice in the oil and gas industry, and that no one argued quantum meruit, the trial judge approached the problem as one sounding in unjust enrichment.[99] It was eventually found, applying the usual tripartite test, that the operator had suffered a net deprivation by overcharging itself processing fees, that the two non-operators had been enriched by the resulting inflated fees, and that the question to be decided was whether there was a juristic reason for the enrichment and deprivation. The trial judge next embarked on a review of the fiduciary duties owed by operators to non-operators to reach the conclusion that the operator failed to provide all pertinent information to the non-operators when it made the proposal to retroactively apply the Jumping Pound formula, and as such its conduct and its breach of fiduciary obligation constituted a juristic reason why the operator "should not be entitled to the benefit of an equitable remedy to rectify an enrichment received by the defendants."[100]

Alternatively, the trial judge reasoned that the processing fee for trucked in production, which was used for the first three years of the operation, constituted a contract between the parties, and, since it was a joint contract, in order for that contract to have been changed, both

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98 *Ibid.* at para. 5.
99 *Ibid.* at para. 8.
100 *Ibid.* at para. 47.

non-operators would have had to consent to the changes. Since at no time did both non-operators agree to any of the iterations of the Jumping Pound formula proposed, no change to the original contract pricing had been made and the original trucked in fee contract should have continued to apply. The existence of the trucked in processing fee contract constituted a juristic reason for the deprivation/enrichment.[101]

4. COMMENTARY

While it is not surprising that, in the absence of a written joint operating agreement, an operator who has been charging itself one processing fee for three years cannot unilaterally decide to retroactively impose a reduced processing fee for itself and demand that the non-operators refund approximately $1 million each; it is surprising that the trial judge embarked on a discussion of unjust enrichment and breach of fiduciary duty to achieve that end. The trial judge's alternative contractual analysis seems to be the most straightforward way to reach the desired conclusion: the parties had an unwritten contract to charge and pay the fee for trucked in production and no change to that fee had been accepted.

Nonetheless, the discussion of the operator's breach of fiduciary duty will be interesting to apply in the future, as the trial judge held that an operator negotiating with non-operators for a change in processing fees is under a fiduciary obligation to provide "all pertinent information" to the non-operators regarding a change.[102]

Further, the fact that the breach of a fiduciary duty provided a juristic reason to deny recovery for unjust enrichment may prove to be a somewhat blunt instrument for future cases. What if the operator had provided the appropriate information? Would the operator have been allowed to recoup some or all of the deprivation?

Finally, one wonders what would have happened had the operator not overreached by asking the non-operators to pay almost $1 million each and had simply told them that, in the future, it would be charging itself a Jumping Pound based fee. Would the case have ever been litigated?

C. *BROOKFIELD BRIDGE LENDING FUND INC. V. VANQUISH OIL & GAS CORP.*[103]

1. BACKGROUND

An operator runs into financial difficulty and is put into receivership. Among its creditors are the non-operators to whom it failed to remit over $300,000 in revenues. The operator has only $58,000 left in its commingled bank account. Can the non-operators use the trust provisions of the *1990 CAPL* to, in effect, get priority over the creditors for the entire amount of the revenue?

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[101] *Ibid.* at para. 54.
[102] *Ibid.* at para. 46.
[103] 2008 ABQB 444, 96 Alta. L.R. (4th) 329 [*Brookfield*].

2. FACTS

The operator of a well governed by the *1990 CAPL*, Vanquish Oil & Gas Corporation, failed to remit to the other working interest owners their pro rata shares of net production revenues, to the extent of $320,539.[104] Instead of being remitted, the revenues were commingled with the other funds of the operator, as permitted by cl. 507 of the *1990 CAPL*. The operator ran into financial difficulties, and, at the time a receiver was appointed, had approximately $58,000 in its commingled account.

The non-operators argued that, notwithstanding that the operator commingled the funds, cl. 507 of the *1990 CAPL* deemed the unremitted funds to be trust funds, and a constructive trust should be imposed over the assets of the operator to the full extent of the $320,539 unremitted funds. The secured creditor argued that any constructive trust would be limited to no more than the $58,000 that remained on deposit at the time of the receivership.

3. DECISION

The trial judge agreed with the non-operators and imposed a constructive trust over all the assets of the operator to the extent of the $320,539.[105] He reasoned that the Alberta Court of Appeal in *Bank of Nova Scotia v. Société Générale (Canada)*[106] clearly held that any pro rata revenue still remaining in the operator's account was held in trust for the non-operators.[107] In considering whether a constructive trust should be imposed over all the assets of the operator, and not just the funds remaining in the account, he reasoned that the operator had blatantly committed a breach of trust. Thus, the issue to be decided was which of the two innocent parties (the operator's secured creditor on the one end, and the non-operators on the other) should bear the loss of the operator's breach of trust. He reasoned that the party who was in a better position to ensure the operator did not commit the breach of trust was the party who should bear the loss. That party, the trial judge held, was the secured creditor who was in "a strong position to ensure that its customer adhere to its obligations by employing such things as borrower's covenants, reporting procedures, etc."[108]

4. COMMENTARY

In effect, giving non-operators priority over the operator's secured creditors to the extent of the value of the unremitted net production revenues certainly will be a powerful tool to protect non-operators when the operator is in receivership. The Court speculated that this priority would not extend to some other creditors who would be regarded as innocent bona fide parties, for example, landlords and employees. One can foresee some interesting priority fights to come.

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[104] *Ibid.* at para. 11.
[105] *Ibid.* at para. 55.
[106] (1988), 87 A.R. 133 (C.A.).
[107] *Brookfield*, *supra* note 103 at paras. 28-29.
[108] *Ibid.* at para. 55(4).

X. TORT

A. *BALL V. IMPERIAL OIL RESOURCES LTD.*[109]

1. BACKGROUND

A pipeline leaked. The repair crew did not adequately warn the rancher involved and did not keep contaminated soil and water within their fenced area. Cattle got into the contaminants. The rancher alleged the cattle had been harmed but there was no direct proof. Could the rancher prove her case?

2. FACTS

An oil and gas company, Imperial Oil Resources Limited, discovered a leak in a pipeline that crossed a ranch. It failed to give the rancher notice of the leak, and notice that it was going to repair the leak. When it repaired the leak, the company temporarily fenced off the immediate area. However, the company placed hydrocarbon contaminated soil on a tarp outside of the fence and in an area accessible to cattle. Further, it pumped hydrocarbon contaminated water from the excavation site onto the grass outside the fenced area. Cattle came into contact with the contaminated soil and were allegedly harmed. The rancher sued.

3. DECISION

The trial judge found the company liable for failing to warn the rancher in a timely fashion about the leak and the work.[110] If the rancher had been warned, the rancher could have moved the cattle to a safe position (which the rancher did, once she learned of the leak and excavation). Further, the company's actions in pouring contaminated water on the ground and leaving contaminated soil unfenced was negligent. The company was also liable in nuisance for allowing the hydrocarbons to escape from the pipeline, contaminating the soil and the water in the area.[111]

The trial judge applied the "material contribution" test for causation.[112] He found that due to the high volatility of the hydrocarbons involved, they are quickly dissipated and unless an animal is euthanized, and an autopsy done almost immediately following exposure, then by the very nature of the substances, they cannot be quantitatively detected in cattle. Therefore, while the trial judge found that it was not possible to prove conclusively that the hydrocarbons caused damage to the cattle, conclusive proof was not required, but merely proof based on the balance of probabilities. Given the differentiation between the health of the cattle exposed to the contamination compared to the rest of the herd, the trial judge found that the only reasonable conclusion was that the exposure to the contamination was a significant factor in the subsequent compromised health of the exposed cattle.[113]

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[109] 2008 ABQB 765, 64 C.C.L.T. (3d) 275.
[110] *Ibid.* at paras. 108-109.
[111] *Ibid.* at paras. 118-19.
[112] *Ibid.* at para. 133.
[113] *Ibid.* at para. 139.

Damages were awarded for out-of-pocket veterinary and medical expenses, low calf weights, increased calf mortality, replacement cows, and lost production. General damages were also awarded in the amount of $20,000 for the inconvenience caused to the rancher by the company's conduct, but no punitive damages were awarded.

4. COMMENTARY

The sympathy of the court was clearly with the rancher. Effective, clear notice to the rancher before work is commenced is obviously ideal, as is keeping contaminated soil within the fenced construction area.

XI. FARMOUT AGREEMENTS

A. *SOLARA EXPLORATION LTD. V. RICHMOUNT PETROLEUM LTD.*[114]

1. BACKGROUND

Under a farmout agreement, an interest is often earned once a well has been "completed." But what constitutes "completion"?

2. FACTS

Under a farmout agreement that incorporated provisions of the *1990 CAPL*, the farmor was the operator and the farmee was required to fund its appropriate share of the expenses until the "completion, abandonment or capping" of the relevant well.[115]

The farmor issued two Authorizations for Expenditures (AFE). The first AFE was for "development drilling" and was to fund the drilling and casing of the well to the contract depth. The second AFE was to fund the perforation of the target formation and to test the gas flow and analyze the results. It referred to "funds requested to Complete and Test the Basal Quartz and Mannville Group for gas production."[116] The farmee paid both. The wellhead and outlet valve were subsequently installed and testing was done that proved that gas existed, but it did not have a stabilized rate that was economic enough to tie-in for production.

The farmor/operator next issued a third AFE that proposed to all parties that the well be fracture stimulated to increase production.[117] The AFE was somewhat ambiguously written and indicated both that the work was a work-over of the well, and also that it was for completion of the well.

The farmee thought that the well had been completed by the work covered by the first two AFEs, and declined to participate in the third AFE. The farmee wrote to the farmor/operator, indicating that it would not participate in the third AFE and that it would instead "go penalty." Under art. 10 of the *1990 CAPL*, a party can only "go penalty" if it has already

114 2008 ABQB 596, 98 Alta. L.R. (4th) 78 [*Solara*].
115 *Ibid.* at para. 1.
116 *Ibid.* at para. 28.
117 *Ibid.* at para. 40.

earned its interest.[118] A dispute subsequently arose as to whether the farmee had earned its interest in funding the first two AFEs and by declining the third. The farmee maintained that the well was completed and the third AFE was a work-over. The farmor maintained that the third AFE was needed to complete the well and that the farmee had not earned any interest.

3. DECISION

The trial judge noted that the farmout agreement incorporated the definition of "completion" from art. 1 of the *1990 CAPL*, which reads:

> "[C]ompletion" means the installation in, on, or with respect to a well of all such production casing, tubing and wellhead equipment and all such other equipment and material necessary for the permanent preparation of the well for the taking of petroleum substances therefrom up to and including the outlet valve on the wellhead and includes, as necessary, the perforating, stimulating, treating, fracing and swabbing of the well and the conduct of such production tests with respect to such well as are reasonably required to establish the initial producibility of the well.[119]

The trial judge noted the definition has not been subject to judicial consideration, but on a plain reading seems to address three aspects: (a) "the equipment and material necessary for the permanent preparation of the well for the taking of petroleum substances"; (b) "as necessary, the perforating, stimulating, fracing and swabbing of the well"; and (c) "production tests that are reasonably required to establish the initial producibility of the well."[120]

The trial judge concentrated on the first aspect, which she said may be the "dominant aspect of the definition,"[121] being whether "there has been the installation of all equipment and material necessary for the permanent preparation of the well for the taking of petroleum products."[122] The onus lies on the farmee to prove on a balance of probabilities that this has occurred. In this case, there was installation of the production tubing and casing, a wellhead valve, an outlet valve, and a flare stack.

The farmor attempted to argue that the well was not completed until the fracture stimulation made it economic to tie the well in, but the trial judge left for another day the question of the degree to which rendering the well economic played into the definition of completion. Instead, she found that, on the evidence before her, she was left in doubt as to what was required for the permanent preparation of the well for taking petroleum substances, and whether all such steps had been taken. Since the onus was on the farmee to prove its case and that all such steps were completed, she decided that the well was not in fact completed.[123]

However, the trial judge also held that the farmor was estopped from maintaining that the farmee had not earned its interest since the farmor's third AFE was ambiguous as to whether

118 *Ibid.* at para. 49.
119 *1990 CAPL*, *supra* note 58, cl. 101(h).
120 *Solara*, *supra* note 114 at para. 78.
121 *Ibid.* at para. 80.
122 *Ibid.* at para. 81.
123 *Ibid.* at para. 88.

it was for completion or for a work-over subsequent to completion. Given that ambiguity, and when faced with the relatively clear letter from the farmee that it considered the well was completed, the failure of the farmor to respond to, and correct, the farmee's misunderstanding estopped it from claiming, once the third AFE work had been done and the well had proved economic, that the farmee had not earned its interest. The trial judge ruled that it was a case of "estoppel by representation relating to a condition precedent."[124] The farmor knew that the farmee believed it had earned an interest and ought to have, but did not, correct that misunderstanding. The trial judge went further to say that the farmor owed a fiduciary or tort obligation to communicate clearly and deal fairly with the farmee, and accordingly, the farmor/operator was obliged to respond to the farmee's assertion that it had earned, particularly as the farmor's own conduct helped induce the mistaken belief of the farmee. It was declared that the farmee had earned its interest and gone penalty.

4. COMMENTARY

The case considers, perhaps for the first time, what is required for completion, and therefore earning, under the *1990 CAPL* for farmout agreements. The trial judge would have preferred to have had full and complete expert testimony on what exact equipment was necessary to complete the well, and what had in fact been done, in order to decide whether completion had occurred.

Further, the judge found that the operator had an obligation to communicate clearly with the farmee. An operator should take care in describing the operations that the AFE is intended to address. It would have been prudent, if the operator had intended for the new work to have been for completion, to have issued a supplementary AFE for the completion rather than a new AFE.

XII. ROYALTY

A. *574095 ALBERTA LTD. V. HAMILTON BROTHERS EXPLORATION CO.*[125]

1. BACKGROUND

A gas royalty was to be calculated using the price paid "at the point of sale" rather than at the "point of production." Does that mean that gas processing charges can be deducted from the price before calculating the royalty?

2. FACTS

In 1987, an oil and gas company sold a number of oil and gas properties to another company and, for tax reasons, was compensated in part by a royalty payable until a total payment of $490.5 million had been received.[126] The royalty ranged from 62.5 percent to 70 percent of "the value of all petroleum substances produced."[127] "Value" was defined to mean

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[124] *Ibid.* at para. 98.
[125] 2008 ABQB 413, 48 B.L.R. (4th) 69.
[126] *Ibid.* at para. 4.
[127] *Ibid.* at para. 7.

"the full price paid by a bona fide purchaser … at the point of sale of the petroleum substances produced, saved and marketed from, or allocated to, the wells located on the said lands excepting the amount of the burdens."[128]

A dispute arose as to whether gas processing costs were to be deducted from the royalty. The royalty payor argued that the wording "petroleum substances produced, saved and marketed from, or allocated to, the wells located on the said lands" indicated that the value was to be calculated as usual at the point of production, the wellhead, which, in effect, would allow gas processing costs to be deducted from the value upon which the royalties charged. The royalty recipient argued that the "point of sale" language in the definition of value was clear: value was to be determined at the point of sale, not point of production, and therefore there is no reason to deduct gas processing charges in calculating value.

3. DECISION

The trial judge noted that the matter fell to be determined based on the contractual language chosen by the parties, and that the real issue is the point at which value is to be calculated.

He noted that this was not a "typical" overriding geologist royalty, where the originators of a play are compensated by the granting of the royalty on hydrocarbons found by the resource developer.[129] Rather, the royalty arose in the context of a sale of producing assets that had substantial value where there were already significant tangibles constructed and paid for to further the gathering and processing of gas. He reasoned that the method for calculating the royalty and implementing that calculation must have been an important part of the negotiation. The language chosen, by its plain meaning, referred to the "point of sale," and not to the point of production.[130]

It was held that the value upon which the royalty was to be calculated was the value at the point of sale, and therefore there were no grounds for deducting the gas processing costs to arrive at a calculation of value. The royalty was therefore to be calculated free of gas processing costs.

4. COMMENTARY

This case emphasizes the need to review the actual terms of a royalty agreement. Many royalty agreements allow for a deduction for gas processing costs, but not all do. Here the terms did not allow for such a deduction.

It is also notable that these costs had not been deducted since 1979. Like the *Cargill* case considered above, the courts seem to be taking an unsympathetic view to plaintiffs who seek to change the way a royalty, or price, is calculated in a long-term contract, arguing in effect that such royalty or price had been miscalculated for years.

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128 *Ibid.*
129 *Ibid.* at para. 29.
130 *Ibid.* at para. 33.

XIII. LIMITATIONS

A. *YUGRANEFT CORP. V. REXX MANAGEMENT CORP.*[131]

1. BACKGROUND

What is the applicable limitation period to enforce a foreign arbitration award in Alberta? The increasingly international character of the Canadian energy patch and the continued development of international arbitration are factors in this case.

2. FACTS

A Russian corporation, Yugraneft Corp. (Yugraneft), obtained an arbitration award in the amount of approximately US$950,000 from the International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation. Yugraneft sought an order from the Alberta Court recognizing and enforcing the international arbitration award. However, it sought the Alberta order more than three years after the award was granted. The defendant corporation, Rexx Management Corp. (Rexx), maintained the claim was barred by the *Limitations Act*.[132] The order related to money that was paid for equipment that was not supplied. Rexx argued that the award was obtained "after Russian oligarchs used fraudulent Russian court proceedings and a machine-gun toting private army to take control of Yugraneft and initiate the arbitration."[133]

3. DECISION

The Court of Appeal held that even if one were to equate the arbitral award with a foreign judgment, the *Reciprocal Enforcement of Judgments Act*[134] does not apply to Russia. Further, for limitation purposes, courts "for more than a century"[135] have treated an action to enforce a foreign judgment as an action upon a contract debt. While the Russian company argued that, "for policy reasons, foreign judgments should be treated as domestic judgments"[136] in the modern age, the Court of Appeal noted that such an approach has been overruled in Ontario and has not been followed in Nova Scotia and Manitoba.[137] Whatever its merits, the Court concluded that legislative action would be required to create parity between domestic and foreign judgments.[138] With an action on a foreign judgment treated as an action on a debt, there is no reason not to apply the normal limitation. Assuming that a foreign arbitration award is to be given at least as favourable treatment as a foreign judgment, the normal limitation period was two years. That period expired before the Russian company brought its action in Alberta. The claim was barred.

131 2008 ABCA 274, 433 A.R. 372 [*Yugraneft*].
132 *Limitations Act*, *supra* note 17, ss. 3, 11.
133 *Yugraneft*, *supra* note 131 at para. 3.
134 R.S.A. 2000, c. R-6.
135 *Yugraneft*, *supra* note 131 at para. 14.
136 *Ibid.* at para. 16.
137 *Ibid.* at paras. 18-22.
138 *Ibid.* at para. 23.

The Russian company also had submitted that the ten year limitation in s. 11, which applies to a "remedial order in respect of a claim based on a[n] … order for the payment of money," should apply.[139] The Court disagreed, as s. 11 only applies to a "judgment order" which, for the purposes of the subsection, the Court found to mean a domestic judgment or order, not a foreign judgment or order. The Court noted its discussion that foreign judgments have been considered contract debts, not judgments, and that s. 11 does not apply.[140]

4. COMMENTARY

The case has received some press in the international arbitration world, as a two-year limitation period is seen as a relatively short period of time for a company to realize that its intended target has assets in Alberta, and then move to have its foreign arbitration award recognized. Leave to appeal has been granted by the Supreme Court of Canada.[141]

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139 *Ibid.* at para. 29.
140 *Ibid.* at para. 32.
141 *Yugraneft Corp. v. Rexx Management Corp*, 2009 CarswellAlta 259 (S.C.C.) (WLeC).