MODERNIZING THE PROPERTY LAWS THAT BIND US: CHALLENGING TRADITIONAL PROPERTY LAW CONCEPTS UNSUITED TO THE REALITIES OF THE OIL AND GAS INDUSTRY

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Practitioners deal primarily with two different methods of interpretation in oil and gas cases: the strict method of interpretation and the liberal method of interpretation. However, in recent decisions such as Bank of Montreal v. Dynex Petroleum *and* Taylor v. Scurry-Rainbow Oil, *the courts refused to apply the common law, instead upholding long-standing industry practices that could not be easily classified into proper legal categories.*

Following a review of the strict interpretation and liberal interpretation methodologies currently used in interpreting oil and gas cases, this article looks more closely at the method of interpretation used by the courts in Dynex *and* Taylor. *This method of interpretation will be referred to as the challenging method of interpretation. The article discusses the key analytical aspects of the challenging method of interpretation, and examines its possible impact on the existing methods of interpretation used in oil and gas cases. Finally, this article concludes with some thoughts about the implications of these cases on oil and gas law.*

Les praticiens traitent essentiellement avec deux méthodes différentes de l'interprétation des affaires pétrolières et gazières: la méthode stricte et la méthode libérale. Cependant, dans les dernières décisions telles que celles de la Banque de Montréal c. Dynex Petroleum *et* Taylor c. Scurry-Rainbow Oil, *les tribunaux ont refusé d'appliquer la common law, mais ont confirmé les pratiques en place depuis longtemps dans ce secteur d'activité, qui sont par ailleurs difficiles à classer dans les bonnes catégories juridiques.*

Après l'étude des méthodologies de l'interprétation stricte et libérale qui sont actuellement utilisées pour interpréter les affaires pétrolières et gazières, cet article examine de plus près la méthode d'interprétation utilisée par les tribunaux dans les affaires Dynex *et* Taylor. *Cette méthode d'interprétation sera considérée comme la méthode défi. Cet article porte sur les aspects analytiques de cette dernière méthode et en étudie l'impact éventuel sur les méthodes d'interprétation existantes pour les affaires pétrolières et gazières. Enfin, cet article se termine avec quelques réflexions sur les implications de ces affaires pétrolières et gazières.*

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I. INTRODUCTION

Writing in 1966, Andrew Thompson, a Professor of Law at the University of Alberta, opined that:

> a *profit à prendre* may be suitable for the categorization of the rights conferred by the oil and gas lease because in English and Canadian common law the *profit à prendre* is a relatively empty vessel. There is so little law about the subject that it can all be summed up in two pages of Halsbury's Laws of England.... An empty vessel is surely an invitation to fill it with a content which will be appropriate, and therefore Canadian courts have the opportunity to develop the nature of the property interest conferred by the oil and gas lease in sensible response to the exigencies and requirements of a thriving petroleum industry adequately responsive to the public interest.[1]

A few years earlier, Thompson had cautioned against the "indiscriminate classification of interests in oil and gas since classifications will be valid only to the extent that accurate analogies can be drawn between the physical and economic facts of oil and gas and the facts of substances of known legal status."[2] In *Scurry-Rainbow Oil Ltd. v. Galloway Estate*,[3] the definitive case on lessors' royalties as interests in land, Hunt J. (as she then was) agreed with the following comment made by Thompson on the decision in *Berkheiser v. Berkheiser*:[4]

> It is a tendency of the legal mind to treat legal categories as if they were the factors of an electronic computer. Thus, if the proper categories are selected and fed into the machine known as "Law," the correct answer to a problem will automatically result. This type of thinking is not of the high order of judicial thought which produced the Berkheiser decision, nor will it reflect the spirit of that decision if in consequence indiscriminate use of categories is substituted for careful analysis in the solution of oil and gas problems.[5]

Were he to comment, Thompson would no doubt find that the "highest order of judicial thought" is reflected in two recent cases, *Bank of Montreal v. Dynex Petroleum Ltd.*[6] and *Taylor v. Scurry-Rainbow Oil (Sask.) Ltd.*[7] — the first addressing the issue of whether an overriding royalty granted by a lessee could constitute an interest in land, and the second addressing the issue of whether a top lease offended the rule against perpetuities. In each of these cases, the courts refused to apply the common law, instead upholding long-standing industry practices that could not be easily classified into "proper" legal categories.

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1 W.H. Ellis, "Property Status of Royalties in Canadian Oil and Gas Law" (1984) 22 Alta. L. Rev. 1, quoting A.R. Thompson, "A Perspective on Petroleum Law" (1966) 1 Can. Legal Stud. 152.

2 A.R. Thompson & D.E. Lewis, "The Berkheiser Case and Lessors' Assignment" (1958) 1 Alta. L. Rev. 249, citing Professor Summers, *Summers Oil and Gas*, vol. 1., s. 1 (Kansas City: Vernon Law Book Co., 1927) at 19.

3 (1993), 8 Alta. L.R. (3d) 225 (Q.B.), aff'd (1994), 23 Alta. L.R. (3d) 193 (C.A.), leave to appeal to S.C.C. refused, 26 Alta. L.R. (3d) 1 (S.C.C.) [*Galloway Estate* cited to Alta. L.R. (Q.B.)].

4 [1957] S.C.R. 387, 7 D.L.R. (2d) 721 [*Berkheiser*] rev'g [1955] 5 D.L.R. 183 (Sask. C.A.), aff'g [1955] 5 D.L.R. 183 (Sask. Q.B.). The Supreme Court of Canada definitively held that an oil and gas lease was a *profit à prendre* at common law.

5 *Supra* note 3 at para. 28, citing Thompson & Lewis, *supra* note 2 at 250.

6 (2002), 208 D.L.R. (4th) 155 (S.C.C.), aff'g (1999), 74 Alta. L.R. (3d) 219, 182 D.L.R. (4th) 640 (C.A.), rev'g (1997), 145 D.L.R. (4th) 499 (Alta. Q.B.) [*Dynex* cited to D.L.R.].

7 (2002), 203 D.L.R. (4th) 38 (Sask. C.A.), rev'g [1999] 5 W.W.R. 424, 1998 CarswellSask 529 (Sask. Q.B.) [*Taylor* (Q.B.) cited to CarswellSask; *Taylor* (C.A.) cited to W.W.R.].

Dynex and *Taylor* cause us to pause and question our current methods of interpreting the property laws that bind us. As practitioners, we deal primarily with two different methods of interpretation in oil and gas cases: the strict or literal method of interpretation and the liberal method of interpretation. Each has its own distinct methodology and analytical style. While the rules of application underlying these methods of interpretation may be different, the game is the same. When the strict or literal method of interpretation is used, the court will focus on the language used by the parties to grant the interest in order to determine the characteristics and duration of the interest granted. If the question involves an analysis of the nature of the interest itself, the court will typically focus on the underlying conceptual model from which that interest derives. If a liberal method of interpretation is used, the court will be free to examine the interest within the context in which it is granted, or will be quite comfortable with applying imperfect analogies to common law categories of property to characterize the nature of the interest. With the liberal method of interpretation, the fit within a traditional legal category may sometimes become somewhat tortured, although the need to adhere to the underlying conceptual model remains strong. Following *Dynex* and *Taylor*, we now have to ask ourselves whether the rules of application have changed or whether the game itself has changed.

Following a review of the strict interpretation and liberal interpretation methodologies currently used in interpreting oil and gas cases, this article will look more closely at the method of interpretation used by the courts in *Dynex* and *Taylor*. For these purposes, we will refer to this method of interpretation as the challenging method of interpretation. We will then discuss the key analytical aspects of the challenging method of interpretation, and will examine its possible impact on the existing methods of interpretation used in oil and gas cases. Finally, we will conclude with some thoughts about the implications of these cases on the sometimes artificial structures of property law we use to support the house of cards we call "oil and gas law."

It is argued, in the end, that the challenging method of interpretation will likely be utilized in the oil and gas context infrequently and that it will be limited to cases involving the characterization of the nature of a property interest, rather than to the interpretation of agreements that grant such property interests. In the case of agreements that grant property interests, it is argued that the challenging method of interpretation will likely further the liberal method of interpretation as the more appropriate method of interpretation in oil and gas cases.

II. TRADITIONAL METHODS OF INTERPRETATION

The importance of the method of interpretation used by a court, whether consciously or unconsciously, to determine what the characteristics of a property interest are, or what property interests a party has been granted, cannot be understated. Process, in matters of interpretation, is as important, and sometimes more important, than the result itself. In fact, quite often the method of interpretation used by a court is determinative of the outcome of the case.

A. STRICT INTERPRETATION

The strict or literal method of interpretation seeks to interpret a word or clause in a document by relying on the plain meaning of the word or collection of words. John Ballem, a leading Canadian authority on oil and gas law, has noted that Canadian courts have typically interpreted oil and gas leases in a strict manner, often resulting in an interpretation that surprises even the drafters of the document:

> The common theme that runs throughout all the judgments is that of strict attention to the actual wording of the particular lease itself, and a determinedly literalistic application of that language. The literalistic approach is subject to one further refinement in that if the language creates an ambiguity, it should be construed against the party who prepared and tendered the document. The lessee, almost invariably, will be the party who proffers the document, so that if there is an ambiguity, it will be resolved in favour of the lessor.
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> The court has seldom been forced to rely upon the maxim, since the wording of individual clauses has usually been found to be clear and free from ambiguity. This is so despite the fact that the court's view of the "clear meaning" has frequently astounded those who originally prepared the document and has caused a good deal of frantic redrafting to reverse the interpretation of the courts.[8]

One commentator has lamented that Canadian courts have placed so much emphasis on the literal construction of a document that "it is difficult to avoid the conclusion that they have looked at it as a collection of words rather than as the embodiment of the arrangements adopted by the parties to achieve the objectives which they had in mind."[9]

The strict or literal method of interpretation can involve a painstaking analysis of the meanings of such simple words as "on" and "in." The royalty cases provide good examples of this type of analysis. In the 1973 case of *Bensette v. Reece*,[10] for example, the Saskatchewan Court of Appeal was asked to determine whether a royalty granted by Burke Land and Development Company to William James Graham and Edward F. Bensette of a "six per cent royalty in all the ... minerals ... which may be found in, under or upon the lands"[11] was an interest in land capable of supporting a caveat filed under the Saskatchewan *Land Titles Act*. In concluding that the interest was an interest in land, Woods J.A. reasoned:

> Had the words "interest" or "property" been used instead of "royalty", it would be clear that an interest in the minerals themselves was to pass. Had the words "payment on" been used instead of "royalty in", intention to pass an interest *in rem* would not be inferable. The question is then as to what is meant by a "royalty" in the "minerals".
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> The words "royalty in" connote an interest of some kind "in" the minerals. If it were "royalty on" the minerals, some kind of commission would be readily inferable.

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8 J. Ballem, *The Oil and Gas Lease in Canada*, 3d ed. (Toronto: University of Toronto Press, 1999) at 101.

9 W.H. Hurlburt, "Judicial Approach to the Petroleum and Natural Gas Lease" (1965) 4 Alta. L. Rev. 196 at 205.

10 (1973), 34 D.L.R. (3d) 723, [1973] 2 W.W.R. 497 (Sask. C.A.) [*Bensette* cited to D.L.R.].

11 *Ibid.* at 725.

> The second paragraph of the portion of the agreement quoted above refers to the royalty being "paid free and clear". It does not specify whether payment is to be made in money or the minerals themselves. The third paragraph does not make this clear either.[12]

The royalty cases that followed *Bensette* utilized this type of analysis, and many royalty agreements that had been drafted prior to that decision were held not to constitute interests in land, the drafters having failed to use the appropriate "magic" words. In *Vandergrift v. Coseka Resources Ltd.*,[13] for example, a 1971 royalty agreement was found to have created a mere contractual right to receive a royalty. The particular clause in question provided that the grantor granted and assigned to the royalty owner "a Three percent (3%) gross overriding royalty out of the 94.4% interest of the Grantor *in all petroleum substances found within, upon or under the lands*."[14] The preamble to the agreement, however, indicated that the grant to the royalty owners was a "Three (3%) percent *gross overriding royalty on all petroleum substances recovered from the lands*,"[15] and yet another clause referred to the royalty owners' "share of production" of petroleum substances. Based on the language, Virtue J. held that the royalty created mere contractual obligations of the grantor:

> In reading the agreement one is struck by the fact that the first reference to the nature of the interest to be conveyed used the expression "royalty on all petroleum substances recovered from the lands", not petroleum within, upon or under the lands, but, those substances "recovered" from the lands. The next reference, in para. 2, is to a royalty on "petroleum substances found". Again, the reference is not to petroleum substances within, upon or under the lands, but to substances "found" within, upon or under the lands. The other references in agreement are to royalty in terms of "a share of production", "petroleum substances sold", "petroleum substances produced". Taken as a whole, I am of the view that the agreement conveys a contractual right to the payment of a royalty on petroleum substances produced from the lands, that is, a share of the petroleum after it has been removed, rather than [an] interest in land.[16]

One wonders how the use of the word "found" before "within, upon or under the lands" turns what might otherwise be construed as an interest in land into a mere contractual right. Presumably, the Court was of the view that if the royalty was to be considered an interest in land it had to exist in the minerals *in situ* whether or not they were found and recovered.

In addition to focusing on words, the strict or literal interpretation also adheres to the policy of strictly applying conceptual tenets of property law. The royalty cases also illustrate this. Justice Virtue continued the analogies in *Vandergrift* by holding that the interest granted did not share one of the key incidents of an interest in land — namely, the right of the royalty holder, like the right of the grantor (the lessee), to explore for and extract the minerals:

> One of the incidents of an interest in land one would expect to find in a royalty agreement intended to create an interest in land would be the right to the royalty holder to enter upon the lands to explore for and extract

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12 *Ibid.* at 726.
13 (1989), 67 Alta. L.R. (2d) 17 (Q.B.) [*Vandergrift*].
14 *Ibid.* at 27 [emphasis in original].
15 *Ibid.* [emphasis in original].
16 *Ibid.* at 28.

> the minerals. A mere entitlement to an overriding royalty, without more, does not, in my view, carry with it the right to explore for oil and gas.[17]

In essence, the Court held that in order for the royalty to create an interest in land, it had to share the same rights and incidents as the interest from which it issued. In this case, it was a *profit à prendre*, an oil and gas lease.

The heyday of the strict method of interpretation occurred in the 1950s and 1960s when, through a series of cases — *East Crest Oil Co. Ltd. v. Strohschein*,[18] *Shell Oil Co. of Canada v. Gunderson*,[19] *Shell Oil Co. of Canada v. Gibbard*,[20] *Canada-Cities Service Petroleum Corp. v. Kininmonth*[21] and *Canadian Superior Oil of California Ltd. v. Kanstrup*[22] — the Alberta Court of Appeal and the Supreme Court of Canada laid the framework for how the habendum clause of the oil and gas lease should be interpreted, with some very interesting results. The two most striking cases are *Gunderson* and *Gibbard*, where the Supreme Court of Canada was asked to consider whether or not the drilling and production of a well on pooled lands rather than the leased lands satisfied the habendum provisions of the relevant lease and continued it beyond the primary term.

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17 *Ibid.*

18 *East Crest Oil v. Strohschein*, [1952] 2 D.L.R. 432 (Alta. S.C. (A.D.)) [*Strohschein*] aff'g (1951), 4 W.W.R. (N.S.) 70 (Alta. S.C. (T.D.)). The Alberta Court of Appeal determined that relief from forfeiture was not available in an "unless" type lease. Ford J.A. noted two earlier cases, *Wetter v. New Pacalta Oils*, [1951] 3 D.L.R. 533 (Alta. S.C. (A.D.)) and *Oil City Petroleums (Leduc) v. American Leduc Petroleums*, [1951] 3 D.L.R. 835 (Alta. S.C. (A.D.)), where those courts considered whether or not to grant relief from forfeiture, determining, in part, that as "time was of the essence" in the oil and gas industry, relief would not be granted. These courts specifically refused to address the issue of whether relief from forfeiture was available. In *Strohschein*, Ford J.A. concluded at 436 that on the "true construction of the lease ... the question of relief from forfeiture does not, at this stage to which the document has become operative, arise. There is no forfeiture to relieve against. There cannot be default in neglecting to do something one is not bound to do."

19 [1960] S.C.R. 424, aff'g (1959), 28 W.W.R. 506 (Alta. S.C. (A.D.)) [*Gunderson*].

20 [1961] S.C.R. 725, aff'g 26 D.L.R. (2d) 400 (Alta. S.C. (A.D.)) [*Gibbard*].

21 [1964] S.C.R. 439 [*Kininmonth*], aff'g (1964), 44 W.W.R. 392 (Alta. S.C. (A.D.)). The Supreme Court of Canada determined that a habendum clause which required production at the expiry of the primary term could not be saved by drilling operations then being carried on, even though a second proviso in the lease contemplated that after the expiry of the primary term, if the leased substances were not being produced on the said lands and the lessee is engaged in drilling or working operations, the lease should remain in force so long as such operations are being conducted and production ensues. The Supreme Court of Canada held that there had to be production at the expiry of the primary term in order for the second proviso to apply.

22 (1964), 47 D.L.R. (2d) 1 (S.C.C.) [*Kanstrup*] aff'g 43 D.L.R. (2d) 261(Alta. S.C. (A.D.)), aff'g 39 D.L.R. (2d) 275 (Alta. S.C. (T.D.)). The Supreme Court of Canada held that the failure to pay a shut-in royalty on or prior to the expiry of the primary term in relation to a shut-in well drilled on pooled lands should be treated in the same way as the Alberta Court of Appeal treated the delay rental in *Strohschein*, *supra* note 18, even though the clause in question did not utilize an "unless" proviso. The relevant clause provided only that "where gas from the well producing gas only is not sold or used, Lessee may pay as royalty $100.00 per well per year, and if such payment is made it will be considered that gas is being produced within the meaning of Paragraph 2 hereof." The habendum clause (para. 2) required production or drilling operations at the end of the primary term. Since the payment of the shut-in royalty was required to "deem" production for the purposes of the habendum, the failure to pay the shut-in royalty prior to the expiry of the primary term meant that there was no production or drilling operations and the lease expired in accordance with its terms.

In *Gunderson*, the lessee pooled certain lands with the leased lands to create a spacing unit for the production of a gas well that had been drilled. The gas well was drilled and shut-in due to the absence of a gathering system in the area. The relevant pooling provision provided that production of leased substances from the pooled lands would have the same effect in continuing the lease as if such production were upon or from the leased lands. The habendum clause required that there be "production" at the end of the primary term in order to continue the lease. When the well was shut in, the lessee paid the applicable shut-in royalties to the lessor. There was no actual production at the end of the primary term. The Court concluded that there was nothing in the habendum, the shut-in provision or the pooling provision that provided that "deemed production" from a shut-in well drilled on pooled lands could satisfy the habendum clause. Indeed, the shut-in royalty clause in the lease referred only to the "said lands" and was not applicable to a shut-in well on pooled lands.

The language in the lease in *Gibbard* was likewise strictly construed. The relevant pooling clause provided that the lessee had the power to pool the lands to form one drilling unit "when such pooling or combining is necessary in order to conform with any regulations or orders of the Government of the Province of Alberta." The leased lands were pooled and a well was drilled, but was shut-in for lack of a market. The well was a gas well and could not be produced without a full spacing unit. In concluding that the pooling section did not serve to extend the primary term of the lease, the Court determined that, there being no obligation to produce under the terms of the lease, a voluntary pooling was not one that was necessary to conform with the regulations.

B. LIBERAL INTERPRETATION

Courts using the liberal method of interpretation typically expand the scope of their inquiry into the plain meaning of the words used in a contract to include an analysis of the relevant industry context and the objectives of the parties within that context.[23] This may involve the interpretation of property law concepts using analysis from other areas of law, such as contract law or equity. It can also involve the court supplying missing terms to an agreement in order to make sense of a gap in the language of the document to ensure that the objectives of the parties are met. As noted earlier, when dealing with the characterization of a property interest, this method of interpretation also allows the court to analogize to existing proper legal categories.

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[23] *Paramount Petroleum and Mineral Corporation Ltd. v. Imperial Oil Ltd.* (1970), 73 W.W.R. 417, (Sask. C.A.). The Saskatchewan Court of Appeal was asked to determine whether a shut-in royalty payment mailed on the expiry date of the primary term of the lease, but not received until after the expiry of the primary term, was effective to continue the lease beyond the primary term. Two previous Alberta decisions, *Canadian Fina Oil Ltd.v. Paschke* (1957), 21 W.W.R. 260 (Alta. S.C. (A.D.)) and *Texas Gulf Sulphur Co. v. Ballem* (1969), 70 W.W.R. 373 (Alta. S.C. (A.D.)), had held that as time was of the essence in the oil and gas industry, the delay rentals and shut-in royalty payments must be received by the lessor prior to the expiry of the anniversary date of the lease. The Court suggested that while these decisions deserved its consideration and respect, it was not bound by them. To the extent both mailing and personal delivery were contemplated, the parties could not have intended that the lessee would assume the risk of transmission through the mail, nor was it reasonable for the lessee to assume the risk of factors outside of the lessee's control.

The number of oil and gas property law cases utilizing the liberal method of interpretation are currently fewer in number than those involving a strict interpretation, and one cannot really speak of the "heyday" of liberalism in the same manner as with the strict construction method of interpretation. That being said, there are four key cases that illustrate the application of this method: *Kissinger Petroleums v. Keith McLean Oil Properties*,[24] *Murdoch v. Canadian Superior Oil Ltd.*,[25] *Cull v. Canadian Superior Oil Ltd.*[26] and *Galloway Estate*.[27]

In *Kissinger*, the Court was asked to determine whether the payment of a shut-in royalty prior to the expiry of a lease was sufficient to hold the lease even though the well was neither completed nor shut-in until after the expiry of the primary term. The particular lease in question provided that if, at the end of the primary term, the leased substances were not being produced, the lease would remain in force so long as any drilling operations were prosecuted, with no cessation for 90 days, if they resulted in production of the leased substances. In accordance with the provisions of this clause, the lessee, having commenced drilling operations prior to the expiry of the primary term of the lease, was entitled to continue drilling operations after the expiry of the primary term. The well was completed approximately two weeks following the expiry of the primary term of the lease but was shut-in for lack of market. The drilling did not result in actual production. The plaintiff argued that the clause, which permitted the lessee to extend the lease provided drilling operations were being conducted, required that the drilling operations had to result in actual production since the clause did not contemplate satisfaction by way of deemed production. Justice McDermid for the Court did not agree, holding that although the word "deemed" was not used, the word "production" could include "deemed production."[28]

Were the Court analyzing the provisions of the lease in a strict or literal manner, it is unlikely that the shut-in royalty clause would have applied to extend the term of the lease. By its language, the shut-in royalty clause required the existence of a well on the lands at the expiry of any year in the primary term (or any year in the extended term) "*from which leased substances are not produced as a result of lack of or an intermittent or unecomonical [sic] or unprofitable market.*"[29] At the expiry of the primary term, the leased substances were not being produced, but this was because the well was not completed, not because of a lack of market, as permitted by the shut-in royalty clause.

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24 (1984), 33 Alta. L.R. (2d) 1, 13 D.L.R. (4th) 542 (*sub nom. Kissinger Petroleums v. Nelson*) (C.A.), aff'g (1983), 26 Alta. L.R. 378, 45 A.R. 393 (Q.B.) [*Kissinger* cited to D.L.R.].

25 (1969), 6 D.L.R. (3d) 464 (S.C.C.), aff'g (1969), 4 D.L.R. (3d) 629 (Alta. C.A.) [*Murdoch* cited to D.L.R.].

26 (1971), 20 D.L.R. (3d) 360 (S.C.C.) aff'g (1970), 16 D.L.R. (3d) 709 (Alta. S.C. (A.D.)), aff'g (1970), 74 W.W.R. 324 (Alta. S.C. (A.D.)) [*Cull*].

27 *Supra* note 3.

28 *Supra* note 24 at 554. Interestingly, the Court also held that the lessor, by accepting the payment as a shut-in royalty, was estopped from arguing that it was improper, even though there was no shut-in well in existence on the lands when the payment was made prior to the expiry of the primary term. McDermid J.A. held, contrary to existing Canadian authority, that as the shut-in payment was accepted and the lessee's subsequent designation of that amount was not objected to by the lessor, the payment complied with the provisions of the shut-in royalty clause.

29 *Ibid.* at 552 [emphasis in original].

In concluding that his decision was the correct one, McDermid J.A. considered the reasonable intentions and objectives of the parties in entering into the lease in the first instance:

> I am fortified in this opinion by considering the result of accepting the appellants' construction. The lessee would have drilled a well which was completed after the expiration of the primary term and which resulted in commercial production. However, owing to a lack of a market, the production could not be sold for at least a year. Notwithstanding this necessary hiatus between the completion of the well and the sale of production, the lessee would lose its lease and well. No lessee would enter into such a lease and no reasonable lessor would expect a lessee to consent to such a term. If the language clearly provided for such a result, so be it; but where there is any other reasonable construction, such should be adopted. A court should adopt a construction which results in a reasonable result rather than one which gives an unreasonable result.[30]

In essence, the Alberta Court of Appeal applied principles of contractual interpretation to the habendum provisions of the lease in order to find a "reasonable" solution to what property law dictates may otherwise have required.

In the earlier *Murdoch* case,[31] the Supreme Court of Canada agreed with the Alberta Court of Appeal when it applied principles of contract law to "uphold" a lease that had terminated as a result of the lessee's failure to pay the applicable shut-in royalty prior to the expiry of the primary term. Technically, the Court did not "uphold" the lease as such, noting that it was prevented from doing so on the authority of *Kininmonth* and *Kanstrup*. The parties, however, had agreed pursuant to the terms of a settlement agreement, albeit without words of re-grant, that the lease was "in good standing and of full force and effect." Justice Johnson concluded that by the terms of the settlement agreement, the lessor had "extinguished" its right to a remedy and, practically speaking, its right to treat the lease as terminated:

> It is, I suggest, not necessary to look beyond the agreement itself to determine the nature of the right that has been created. The preamble to the agreement recites that the parties have agreed to settle their disputes. One of these disputes concerned the continued validity of the lease.... The covenant resolves this dispute by the appellant ratifying and confirming that "the said lease is in good standing and of full force and effect". The right is contractual and I do not think it is necessary to look elsewhere for other rights which might have been created by it.
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> The agreement settled the dispute by the parties agreeing that the lease should be treated as good no matter what the ultimate result of the litigation might be. This they were entitled to do. Probably the most concise statement, among the many which lay this down, is that of Williams J., in *M'Cance v. London & North Western Railway Co. (1864)*, 3 H. & C. 343 at p. 345, 159 E.R. 563:
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> > It is laid down in my brother Blackburn's Treatise on the Contract of Sale, p. 163, that "when parties have agreed to act upon an assumed state of facts their rights between themselves are justly made to depend on the conventional state of facts, and not on the truth." Applying that

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30 *Ibid.* at 556 [citation omitted].

31 *Supra* note 25.

> rule to the present case, we think that both parties are bound by the conventional state of facts agreed upon between them.[32]

In effect, the Alberta Court of Appeal applied principles applicable to contract law to the issue of the validity of the lease, with the strange result that although the lease had clearly terminated, neither party could assert that termination against the other party as the basis for a cause of action. This would not, however, prevent an interested third party from doing so.

In *Cull*,[33] the lessee had commenced drilling a well prior to the expiry of the primary term and was entitled to continue to drill to completion "with reasonable dispatch" after the expiry of the primary term and the lease would continue in full force and effect as if the well had been completed during the primary term and oil or gas was found thereon in paying quantities. The primary term of the lease expired on 29 December 1957. Drilling of the well commenced on 28 November 1957, and continued until 30 December 1957, when the main drilling rig was rig-released. On 3 January 1958, some casing was lost in the well and was not recovered until 5 January. The well became capable of producing on 7 January 1958, but as there was no equipment to treat and store production, the well was shut-in. The well was re-opened on 11 January 1958, and actual production commenced 18 January 1958, eleven days following completion of the well and production of leased substances. The issue before the Court was whether this gap in time operated to terminate the lease.

In holding that the lease was valid, the Supreme Court of Canada relied heavily on the *bona fide* intention of the lessee to proceed diligently to place the well on production.[34] Although the well had been completed on 7 January 1958, and it would have been physically possible to produce oil from the well directly onto trucks, the Court accepted evidence that "no prudent operator would have considered doing this because of the danger of hydrogen sulphide." In upholding the continued validity of the lease, the Supreme Court of Canada referred to the views of the Alberta Court of Appeal, where Johnson J.A. found as follows:

> [R]educed to its simplest terms ... given a ready market for oil, does the combined effect of these clauses require that production be taken the very moment that the well has been completed? ... Certainly there is nothing in the evidence to suggest that, having regard to the usual oilfield practice, it would ever be possible to have production at the exact moment the well was completed....
>
> It is not reasonable, I suggest, to apply so stringent an interpretation. Wells are not permitted to produce constantly....

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32 *Ibid.* at 636-37.

33 *Supra* note 26.

34 The lessee's *bona fide* intent to proceed diligently to drill a well to completion was also significant in *Canadian Superior Oil Ltd. v. Crozet Exploration Ltd.* (1982), 18 Alta. L.R. (2d) 145 (Q.B.) when the Court broadly defined the term "operations." The following activities were held to be "operations for or incidental to" drilling: hauling of gravel to the site for stabilization purposes, construction of an access road, drilling of "rat" and "mouse" holes, erection of a drilling platform and obtaining a well licence. In order for these actions to come within the meaning of "operations" for the purposes of the habendum clause, the Court noted that the actions must be taken with "reasonable diligence," in "good faith" and "with the intention of completing the drilling of an oil and/or gas well."

> This was but the second well which was drilled in the area and while it could not be classified as a wildcat well, it could not be said to be an established production area. The evidence is that when drilling such wells it is not usual to construct the tank battery until it has been determined that production can be obtained.[35]

The Court noted that the habendum clause provided for continuation after the primary term "so long ... as Lessee shall conduct drilling, mining or re-working operations thereon as hereinafter provided and during the production of oil, gas or other mineral resulting therefrom," concluding that the requirement of production therefrom did not mean production obtained immediately therefrom, but production obtained with reasonable diligence and dispatch therefrom.

Rowland Harrison, then Assistant Professor in the Faculty of Law at Dalhousie University and now a member of the National Energy Board, commented on *Cull* in a 1972 paper written for the Canadian Petroleum Law Foundation's Tenth Annual Research Seminar, stating that the significance of the decision cannot be overestimated:

> In the first place, it is submitted that there is no reason why, logically, the same considerations should not apply to the payment of shut-in royalties within a reasonable time after completion of a well....
>
> Secondly, the comment of Johnson J.A. that the realities of the situation and the purposes of the lease are to be kept in mind have a wider significance. It is suggested that they indicate a move away from the previous strict interpretation applied by the Courts to petroleum and natural gas leases.[36]

Interestingly, a similar finding had been made by the Ontario Court of Appeal in 1942 in *Stevenson v. Westgate*,[37] where the Court concluded that production for the purposes of the habendum did not mean "continuous production":

> While appellants are entitled to have a construction placed upon these words that will assure them of the continued operation of any well upon their land, so that they may be assured of a reasonable return so long as respondents continue to occupy, at the same time, this is a business arrangement, and regard must be had to the reasonable requirements of the business. It is not the fair meaning of the agreement that without interruption respondents must produce a constant flow of oil in paying quantities, or lose their right to continue

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35 *Supra* note 26 at 365-66, citing Johnson J.A. at 713-75 (Alta. C.A.). Johnson J.A. also held, at 714-15, that in interpreting these clauses, "we must keep in mind the realities of the situation and the purposes which are contemplated by the lease." The Supreme Court of Canada distinguished two earlier cases, *Kanstrup, supra* note 22 and *Canadian Superior Oil Ltd. v. Paddon-Hughes Development Co. Ltd.* (1970), 12 D.L.R. (3d) 247 (S.C.C.), aff'g (1970), 3 D.L.R. (2d) 10 (Alta. S.C. (A.D.)), where the applicable shut-in royalty payments were not made until shortly after the primary term expired. The Court viewed the "privilege" of paying money to establish deemed production differently than the right to suspend production for a period following completion of the well in order to properly equip the well for production, primarily as a result of the lessee's apparent *bona fide* intention to complete and produce the well as soon as reasonably practical.

36 R.J. Harrison, "Selected Cases, Legislation and Developments in Oil and Gas Law" (1972) 10 Alta. L. Rev. 391 at 397-98.

37 [1942] 1 D.L.R. 369 (Ont. C.A.) [*Stevenson*]. The Court was asked to determine whether the habendum provision of the oil and gas lease required "continuous" production or whether cessation of production, as had occurred, resulted in termination of the lease. In this case, production ceased because the lessee needed to raise more money to continue operations. Negotiations with the lessee's lenders and the lessor's mortgagee were protracted and operations were suspended for a period.

> operating. Operations may be interrupted from causes not chargeable to respondents. There may be times in the course of operations when it cannot be said that they are paying. In my opinion a more liberal interpretation must be placed upon the terms of the agreement than to say, "if there is such occasion, the lease terminates."
>
> ...
>
> Oil had been found and it was possible to pump in quantities that certainly were more than sufficient for the then current charges. But it was reasonable, when respondents had got this far, to discontinue pumping while the necessary things were done to provide for larger development and more profitable operation. It was only doing what the parties may reasonably be deemed to have contemplated in their arrangement.[38]

Finally, Hunt J.'s decision in *Galloway Estate*[39] should be mentioned as perhaps the most significant of the liberal interpretation cases in that her approach goes beyond the scope of interpretation used in earlier cases and involves the technique of analogizing to "proper legal categories."[40] The facts in this case are complex and will not be repeated here nor will all the issues in that case be canvassed. For our purposes, Hunt J.'s comments in relation to one particular issue is significant. To the extent that Hunt J. characterized a lessor's royalty as analogous or akin to rent at common law, it was argued that the assignment of the lessor's royalty could not give the assignee of the royalty an interest in land. In this case, the assignment of the lessor's royalty was to a trustee under the terms of a trust agreement. In the earlier case of *Canada Trustco Mortgage Co. v. Skoretz*,[41] Miller J. had concluded that it was not possible to characterize a royalty under a Trust Agreement as rent since an assignment of rent does not, at common law, create an interest in land.[42]

Justice Hunt did not find this an impediment to her characterization of a lessor's royalty as analogous to rent, or to her finding that an assignee of a lessor's royalty could acquire an interest in land in relation to the assignment:

> Even if at common law an assignment of rent cannot be an interest in land, the interest under consideration here can be treated as analogous to rent.... And if the interest is akin to rent, it is the analogy that is persuasive, not a technical barrier arising from the common law concept of rent and its non-assignability as an interest in land.
>
> The defendants argue that if this royalty is to be treated as an interest in land, it must fall into some pre-existing legal category, and not be considered as analogous to an existing interest such as rent.... I do not find this argument compelling....

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38 *Ibid.* at 371-72.

39 *Supra* note 3.

40 *Ibid.* This case could also be considered as a case where the Court utilized the challenging method of interpretation. However, for the purposes of this article, it is noteworthy that the legislature had already stepped in to determine that the interest in question — that is, the interest held by an assignee of a lessor's royalty — was an interest in land. In addition, the fact that Hunt J. believed it was important to "fit" the characterization into a traditional legal category suggests that this case is distinguishable from *Dynex*, *supra* note 6 and *Taylor*, *supra* note 7. It can, however, be characterized as an aggressive form of liberal interpretation.

41 [1983] 4 W.W.R. 618, 26 Alta. L.R. (2d) 60 (Q.B.).

42 *Law of Property Act*, R.S.A. 2000, c. L-7, s. 4 now provides that an assignment of rents payable pursuant to a lease of land is an equitable interest in land.

> [T]he approach suggested by the Defendants seems to me to take far too restrictive a view of the evolution of the law.... The ingenuity of the human mind in creating legal relationships and devices is boundless.
>
> [T]he unique physical properties of oil and gas have always caused the courts to be creative, and at times to analogize. That is exactly the situation here....
>
> But in any event, as I have already pointed out, there is language in *Berkheiser* to suggest that a royalty is a species of profit.[43]

III. THE CHALLENGING METHOD OF INTERPRETATION

The challenging method of interpretation is best expressed by Holmes J. in "The Path of Law," cited by the Alberta Court of Appeal in *Dynex*:

> [It is] revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV [and] still more revolting if the grounds upon which it was laid down have vanished long since, and the rule persists from blind imitation of the past.[44]

Unlike the strict and liberal methods of interpretation, which interpret and "apply" the law, the challenging method of interpretation permits us to analyze the principle of law that we are asked to apply to determine whether or not it continues to make sense to apply it. This was the method of interpretation utilized by the Courts in *Dynex*[45] and *Taylor*.[46]

A. OVERRIDING ROYALTIES AS INTERESTS IN LAND

At issue in *Dynex* was whether, as a matter of law, an overriding royalty, defined by the Court of Appeal as "an unencumbered share or fractional interest in the gross production to a third party in exchange for performing duties (*i.e.*, *drilling*),"[47] is capable of being an interest in land. Previous cases dealing with overriding royalties did not typically address this issue, focusing instead on whether the agreement contained the appropriate magic words necessary to create an interest in land. To understand why this is an issue, it is necessary to understand the nature of the *profit à prendre*, which is the interest granted to a lessee under an oil and gas lease.

A *profit à prendre* is defined at common law as a right to take something off the land of another person, and is classified as an incorporeal hereditament. As Oosterhoff and Raynor explain,

> Real property may be classified as either a *corporeal* or an *incorporeal* hereditament.
>
> A *hereditament* is a right that is inheritable or in other words a right capable of passing by way of descent to an heir. At common law only realty, as opposed to personalty, had this capability.

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43 *Supra* note 4 at 266-67.
44 *Supra* note 6 at 162, citing Holmes J., "The Path of Law" (1897) 10 Harv. L. Rev. 457 at 469.
45 *Ibid.*
46 *Supra* note 7.
47 *Supra* note 6 at 648 (Alta. C.A.).

> A corporeal hereditament is land and all physical matter which can be seen or handled which is part of or affixed to land over which ownership is exercised.
>
> An incorporeal hereditament on the other hand is a right growing out of or concerning or annexed to a corporeal thing. It is not the corporeal thing itself but something collateral thereto. It is a mere right as opposed to the physical object. The importance of an incorporeal hereditament in the law of real property is that the law of real property applies to it as it does to corporeal land.
>
> Not all rights relating to land are incorporeal hereditaments. Historically only certain rights have been so recognized. These include such rights as (a) a rent charge, (b) an easement and (c) a *profit à prendre*.[48]

At common law, a *profit à prendre* is not an interest in land itself, but an interest *in relation to* land. Its relation to land permits it to be subject to the laws of real property in much the same way as an interest in land. The distinction between interests in land and interests in relation to land when referring to minerals *in situ* is difficult to conceptualize. Mines and minerals seem so much a part of the land that at least two early Ontario cases suggested that an oil and gas lease in the nature of a *profit à prendre* was, in effect, "a grant of the ownership of such portions of the land as are conveyed"[49] and "when properly considered, an out-and-out sale of a portion of the land. It is liberty given to a particular individual, for a specific length of time, to go into and under the land, and to get certain things there if he can find them, and to take them away, just as if he had bought so much of the soil."[50] These cases, however, are not consistent with the concept of a *profit à prendre* at common law, and the notion that a *profit à prendre* involved a sale of minerals *in situ* was expressly rejected by the Supreme Court of Canada in *Berkheiser*[51] when it overturned the Court of Appeal's decision on that point.

The distinction between the land (as a corporeal hereditament) and an interest in relation to land (as an incorporeal hereditament) is easier to understand when considered in other contexts. Prior to the discovery of mines and minerals, most *profits à prendre* were granted in relation to things that existed "on" the land or grew "in" the soil and were easily detachable from the land. Consider a *profit à prendre* comprising the right to fish from a private pond[52] or the right to kill, shoot or sport pheasants on the land of another.[53] These rights, like the right to recover petroleum substances from the land of another, are incorporeal hereditaments entitled to treatment as interests in land. It is easy to see that fish and rabbits are not land, nor are they interests in relation to land in and of themselves. Rather, the relational interest to land acquired by the holder of a *profit à prendre* is comprised of: (a) the right to enter on the land and capture the subject matter of the grant (be it fish, rabbits or

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48 A.H. Oosterhoff & W.B. Raynor, eds., *Anger and Honsberger Law of Real Property*, 2d ed. (Aurora: Canada Law Book, 1985) at 923.

49 *Cherry v. Petch*, [1948] O.W.N. 379 at 380 (Ont. H.C.).

50 *Canadian Railway Accident Co. v. Williams* (1910), 21 O.L.R. 472.

51 *Supra* note 4.

52 *Fitzgerald v. Firbank*, [1897] 2 Ch. 96.

53 *Mason v. Clarke*, [1955] A.C. 778; *Lowe v. Adams*, [1901] 2 Ch. 598.

natural gas); and (b) as a necessary incident to that right,[54] the right, upon capture, to possess the subject-matter of the grant and remove it from the land (be it fish, rabbits or natural gas).

Upon possession, the subject-matter of the grant becomes personal property of the holder of the *profit à prendre*. Once the subject-matter of the grant is captured and reduced to possession, the right in relation to the land (that is, the right to enter upon the land and capture the subject-matter), having been exercised, is extinguished, at least in relation to the captured subject-matter. The right, in other words, does not "run" with the subject-matter of the grant after it has been captured and reduced to possession.

At common law, an interest in land could not issue out of an incorporeal hereditament but it could issue out of a corporeal hereditament.[55] The grant of a *profit à prendre* is non-exclusive unless it expressly provides that it is exclusive.[56] The landowner could retain for himself the right to exercise the same rights as those granted to the holder of the *profit à prendre*, or the landowner could grant additional *profits à prendre* to other persons. The practice, of course, is to grant exclusivity, otherwise the value of the right is significantly reduced. However, whether or not the right is exclusive to the holder of the *profit à prendre* is a matter requiring the agreement of the landowner, because the landowner is giving up his own rights to work the lands or to grant additional rights to third parties. The agreement of the landowner, without more, does not assign to the holder of the *profits à prendre* the right to grant interests in relation to land *in addition to* the lessee's exclusive *profit à prendre*.

This interpretation of the common law nature of a *profit à prendre* prompted one early commentator to question whether the decision to classify a freehold oil and gas lease in Canada as a *profit à prendre*, an incorporeal hereditament, had "unwittingly foreclosed the practical use of royalties, especially overriding royalties."[57]

In order to hold that a lessee of an oil and gas lease can, in law, pass on an interest in land to a third party, a more liberal interpretation of the nature of a *profit à prendre* would be required, such as that expressed by the Ontario courts earlier in this century, that the *profit à prendre* involved a "grant of the ownership of such portions of the land as are conveyed." Alternatively, a liberal interpretation of an overriding royalty may have concluded that it is comprised in part as an assignment of a portion of the *profit à prendre* from the lessee to the overriding royalty holder, and in part as a contractual agreement between the lessee and the overriding royalty owner concerning such matters as: (a) one party's exclusive right to enter upon the land and conduct operations for the recovery of petroleum substances; and (b) the allocation of costs of that exercise as between the parties. Certainly, on a contractual basis,

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54 *Supra* note 52. It was argued in *Fitzgerald v. Firbank*, *supra* note 52, that a *profit à prendre*, without more, gave only the right to catch fish but no right to carry them away. The Court in *Mason v. Clarke*, *supra* note 53, disagreed, holding at 101 that the "right of fishing includes the right to take away fish unless the contrary is expressly stipulated."

55 *Keyes v. Saskatchewan Minerals*, [1972] S.C.R. 703 at 721-22, 23 D.L.R. (3d) 573 [*Saskatchewan Minerals* cited to S.C.R.]. See also the discussion by Laskin J. in his dissenting opinion in this case.

56 *Duke of Sutherland v. Heathcote*, [1892] 1 Ch. 475 at 484-85, where the Court noted that "such a right does not prevent the owner from taking the same sort of thing from off his own land; the first right may limit, but does not exclude, the second. An exclusive right to all the profit of a particular kind can, no doubt, be granted; but such a right cannot be inferred from language which is not clear and explicit."

57 Ellis, *supra* note 1 at 1.

the parties are entitled to agree as to who will conduct operations and that they will not share the costs of operations on a proportionate basis. A third way, which the Alberta Court of Appeal attempted in *Dynex*,[58] is to analogize the overriding royalty to a form of common law "rent," which is an interest in land.

Using the strict method of interpretation, Rooke J. at the trial level of *Dynex* held that, as a matter of law, a lessee of an oil and gas lease which, as a *profit à prendre*, is itself an interest in land obtained from a lessor, cannot pass on an interest in land.[59]

The Alberta Court of Appeal disagreed, holding as follows:

> We are of the view that overriding royalties can be interests in land. There are practical reasons why ORRs should be treated as interests in land and where an agreement expresses the appropriate intentions, parties can grant or reserve interests in land.[60]

The Alberta Court of Appeal began its analysis by adopting the approach taken by Hunt J. in *Galloway Estate*,[61] where she cautioned against both a reliance on American authorities and a rigid reliance on English common law and held that documents should be interpreted within an industry context. The industry context was of particular importance to the Alberta Court of Appeal's determination that overriding royalties can constitute interests in land. In particular, the Court noted that:

(a) the functions of overriding royalties are the same as lessors' royalties and the "fact that overriding royalties are not granted from the whole of the mineral interest but from the working interest does not change their role in oil and gas production";[62]
(b) the oil and gas industry has traditionally assumed that overriding royalties were interests in land, that "many transactions over many years have been predicated on this assumption," and that there is support in the literature for classifying overriding royalties as interests in land on the basis of expediency;[63] and
(c) there are numerous *practical reasons* for supporting the position that royalties can be interests in land, including the following:
    (i) classifying overriding royalties as interests in land would meet with industry expectations and assumptions and that this would promote certainty and stability in the industry;
    (ii) if the Court held that overriding royalties could not be interests in land, some oil and gas companies with leases encumbered by overriding royalties might be worth more to a bank holding the leases as security if the company was

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58 *Supra* note 6 (Alta. C.A.).
59 *Ibid.* at 503 (Alta. Q.B.).
60 *Ibid.* at 647 (Alta. C.A.).
61 *Supra* note 3.
62 *Supra* note 6 (Alta. C.A.) at 650, citing three important characteristics of royalties in the oil and gas described by Ellis, *supra* note 1 at 2-3: "(1) spreading the risks of exploration; (2) offering incentives to induce investment by offering the hope of a share in production from a successful venture; and (3) compensation for obtaining good geological information or for employees whose efforts determine the success of a project."
63 *Ibid.* at 651, citing Edward Evans *et al.*, "Overriding Royalties and Subleases as Interests in Land" Mid-Winter Meeting, Alberta Branch, Canadian Bar Association (1988) at 406-57.

petitioned into bankruptcy and the bank could sell the leases free of the overriding royalties; and

(iii) treating overriding royalties as interests in land protects royalty owners against double conveyancing, whether innocent or fraudulent.

The Court wholly dismissed the argument that an interest in land could not be issued out of an incorporeal hereditament:

> The principles inherent in the above argument need not be applied to prevent an overriding royalty from being an interest in land for a number of reasons. First, royalties and ORRs need not be classified into a traditional common law property category unsuited to the realities of the oil and gas industry and need not be subject to the arcane strictures of traditional categories. Second, some authorities suggest it is possible to have an incorporeal interest (an overriding royalty) created from an incorporeal interest. Third, even if it is not possible, the rule need not be blindly adhered to.[64]

At a certain point in the decision, the Court reverted to the liberal method of interpretation when it attempted to categorize an overriding royalty into the traditional property law concept of rent. The Court cited the analysis of Hunt J. in *Galloway Estate*,[65] where she held that lessors' royalties can be an interest in land in the form of a species of rent or as akin to rent or a *profit à prendre*. A rent-charge, at common law, is compensation which the occupier pays the landlord for that species of occupation which the contract between them allows,[66] with the lessor's interest in the land being derived from its reversionary interest. The Court further noted that Laskin J., in his dissenting opinion in *Saskatchewan Minerals*, suggested that an overriding royalty could also be considered to be analogous to a rent-charge at common law, when he suggested that, in their nature (as compensation), overriding royalties are properly rents — and the overriding royalty is of a similar nature.[67]

By making this analogy, the Court had to reject the common law rule that there can be no rent on a rent on the basis that the second rent-charge (the overriding royalty) had no right of distress. The Court noted that there was an ancient (albeit abolished) form of rent called "rentseck" upon which there was no right of distress and also noted that "no Canadian case has held that overriding royalties cannot be created as a property interest on the basis that a rent cannot be created out of a rent."[68]

Having previously concluded that royalties, whether derived from the estate of a lessor or a lessee, performed the same functions in the oil and gas industry, and having concluded that an overriding royalty could be considered analogous to a rent-charge, the Court held that:

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64 *Ibid.* at 654.

65 *Supra* note 3.

66 *Ibid.* at 238. Quoting Denman C.J. in *R. v. Westbrook*; *R. v. Everis* (1974), 10 Q.B. 178, 116 E.R. 69 at 79-80.

67 *Supra* note 55 at 724.

68 *Dynex, supra* note 6 at 656 (Alta. C.A.).

> For all intents and purposes, an overriding royalty is the same as a royalty; both are an unencumbered share of production. To distinguish between these two forms of royalty is to place form before substance. Royalties, whatever their origin, should be subject to the same set of rules.[69]

Finally, the Court suggested that the overriding issue was whether the parties intended to create an interest in land, and set out a number of indicia that could be used to identify whether or not an interest in land was intended:

> (1) The underlying interest is an interest in land (corporeal or incorporeal);
> (2) The intentions of the parties, as evidenced by the language of the grant and any admissable evidence of the surrounding circumstances or behaviour, indicate that it was understood that an interest in land was created/conveyed;
> (3) The interest is capable of lasting for the duration of the underlying estate.[70]

The decision was upheld by the Supreme Court of Canada, which suggested that it "should come as no surprise that some common law concepts, developed in different social, industrial and legal contexts, are inapplicable in the unique context of the industry and its practices."[71] The Supreme Court of Canada does not appear to have adopted the Alberta Court of Appeal's attempt to analogize an overriding royalty to the common law concept of a rent-charge, however. Instead, the Court recognized the need to change the common law, noting that the appellant "could not offer any convincing policy reasons for maintaining the common law prohibition on the creation of an interest in land from an incorporeal hereditament other than fidelity to common law principles."[72] The Court cited an earlier Supreme Court of Canada decision, *Friedmann Equity Developments Inc. v. Final Note Ltd.*, in which Bastarache J. outlined three circumstances when changes to the rules of common law were necessary: "to keep the common law in step with the evolution of society, to clarify a legal principle, or to resolve an inconsistency."[73]

In addition, the Supreme Court stated that the change should be incremental and its consequences must be capable of assessment.[74] In the result, the Supreme Court of Canada determined that it was necessary to change the rules of the common law to keep it in step with the development of Canada's oil and gas industry.

What followed next is very interesting. The Court cited *Vandergrift*[75] as a case that succinctly stated the appropriate method for determining whether a royalty is an interest in land, and that is by analyzing the language used in describing the interest. Those who prefer the strict method of interpretation can at least take comfort that earlier cases, whether involving lessors' or lessees' royalties, that struggled with "in" or "on" or with the implication of using the word "found" may still be relevant.

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69 *Ibid.* at 653.
70 *Ibid.* at 661.
71 *Ibid.* (S.C.C.).
72 *Ibid.*
73 [2000] 1 S.C.R. 842 at para. 42, cited *ibid.* at 162 [*Friedman Equity Developments*].
74 *Supra* note 6 at 162 (S.C.C.).
75 *Supra* note 13.

B. RULE AGAINST PERPETUITIES

You may recall studying the rule against perpetuities, even if only vaguely. The rule has been succinctly described as follows:

> No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.[76]

The rule operates to declare contingent interests void *ab initio* if the interest will not vest with certainty within the perpetuity period. Even though books have been written on the topic, the rule seems an anathema to us today. Most provinces have modified the common law rule against perpetuities. In Alberta, for example, the legislation permits a contingent interest to vest within an eighty-year period before it will be held to be invalid.[77] In Saskatchewan, however, Bill 42, *An Act to abolish the Rules Against Perpetuities and The Accumulations Act and to enact Consequential Amendments*, was introduced on 10 March 1995, and was debated, but never passed.

Morris and Leach discuss the early rationale for the rule as a means to facilitate the transition of English society from feudalism to democracy:

> The rule against perpetuities began life as a part of the land law designed to prevent the tying up of the soil of England in the hands of the great families.... The rule against perpetuities was made necessary by the fact that, soon after the seventeenth century, courts ruled that it was possible to create contingent future interests in both freeholds and terms of years which the holder of the present interests therein could not destroy. Hence, some new rule seemed to be required to prevent the creation of an infinite series of contingent future interests which would effectively withdraw from commerce more and more land. The rule against perpetuities is also ... designed to prevent the Church from getting into its hands an excessive amount of land, the one basic resource. It is interesting to reflect that the rule against perpetuities and its kindred succeeded in preventing enormous concentrations of land in the hands of a very few and thereby brought it about that England never suffered unbearably from those conditions which elsewhere have produced violent social revolution — land hunger, a class of serfs or peons and widespread destitution.[78]

In modern times, the rule against perpetuities is said to be a rule concerned with remoteness of vesting.

In the oil and gas cases, the rule has been considered in four circumstances: the first involving rights of first refusal; the second involving perpetual options to renew an oil and gas lease; the third involving a covenant in a royalty trust agreement to reserve the royalty in future leases; and the fourth involving top leases.

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[76] J.H.C. Morris & W.B. Leach, *The Rule Against Perpetuities* (London: Stevens & Sons, 1956) at 1. If no life in being is referenced, the interest must vest within 21 years of the date of the instrument.

[77] *Perpetuities Act*, R.S.A. 2000, c. P-5, s. 18.

[78] *Supra* note 76 at 11.

In the first case, *Canadian Long Island Petroleums Ltd. v. Irving Industries (Irving Wire Products Division) Ltd.*,[79] the Supreme Court of Canada was asked to determine whether or not a right of first refusal clause in a joint operating agreement was an interest in land, and if so, whether it was void for offending the rule against perpetuities. The Court concluded that a right of first refusal was not an interest in land[80] but was a personal covenant, and as such was not subject to the rule against perpetuities.[81]

The second case involved a perpetual option to renew an oil and gas lease. In *Canadian Export Gas & Oil Ltd. v. Flegal*,[82] the oil and gas lease in question would need to be renewed if there was no production at the end of the primary term. At common law, options to renew true leases are an exception to the rule and the Court was asked to determine whether a perpetual option to renew an oil and gas lease which, in its nature, is a *profit à prendre* rather than a true lease, could also be construed as an exception to the rule. Since the Court could not find any case law on point, it concluded that it would have to decide the issue on the basis of whether a perpetual option to renew an oil and gas lease offended the rationale behind exceptions to the rule. Citing Morris and Leach, the Court noted that "to apply the rule to options in a lease is undesirable because the improvement of the land is stimulated, not retarded, by the existence of an option, and since the basis of the rule itself is to achieve full utilization of the land, the exception is justified."[83] In concluding that this rationale did not apply to a perpetual option to renew an oil and gas lease, the Court held that:

> To permit perpetual renewal of a lease, stimulates development while renewal of this profit — which only becomes necessary if there is no development — encourages sterilization. While I acknowledge that there may be conservation principles in favour of sterilization today, conservation cannot be said to be a rationale of the rule against perpetuities.[84]

The Court characterized the purpose of the rule against perpetuities as a rule designed to favour "free alienation and full use of property." Many provinces had modified the rule by legislation, rather than abolishing it, confirming to the Court that the rule was not "an archaic common law technicality, the reasons for which have now ceased to exist."[85]

It should be noted that in *Flegal*, the lessee had not developed the lease and had paid only nominal amounts on account of rentals. A subsequent case, *PanCanadian Petroleum Ltd. v. Husky Oil Operations Ltd.*,[86] involved two leases, each with a primary term of twenty-five years and so long thereafter as the leased substances are being produced, subject to the renewal of the said term. The difference in this case, however, was that one of the leases

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79 [1975] 2 S.C.R. 715, [1974] 6 W.W.R. 385, aff'g [1973] 5 W.W.R. 99, 37 D.L.R. (3d) 244 (Alta. S.C. (A.D.)), aff'g [1973] 2 W.W.R. 526, 31 D.L.R. (3d) 244 (Alta. S.C. (T.D.)) [cited to S.C.R.].

80 *Ibid.* at 735. Note that rights of first refusal are now considered interests in land under the provisions of the *Law of Property Act*, R.S.A. 2000, c. L-7, s. 72(1). *Quaere* whether rights of first refusal may now be subject to the rule against perpetuities.

81 *Ibid.*

82 [1978] 1 W.W.R. 185, 80 D.L.R. (3d) 679 (Alta. S.C. (T.D.)) [*Flegal* cited to D.L.R.].

83 J.H.C. Morris & W.B. Leach, *The Rule Against Perpetuities*, 2d ed. (London: Stevens & Sons, 1962) at 225.

84 *Supra* note 82 at 684.

85 *Ibid.*

86 (1994), 26 Alta. L.R. (3d) 203, [1995] 4 W.W.R. 40 (Q.B.).

(referred to as the "Shallow Rights Lease") had continued beyond the primary term under the "so long thereafter" clause of the habendum and had been producing since 1992. Notwithstanding this, the Court concluded that, based upon the decision in *Flegal*,[87] the option to renew clauses in both of the leases offended against the rule against perpetuities, and the options in respect of each of them were unenforceable.

In a case decided one year earlier, Hunt J., applying the approach of the Court in *Flegal*, determined in *Galloway Estate*[88] that the rule against perpetuities was not offended by a clause in a royalty trust agreement whereby the vendor covenanted with the purchaser to reserve the royalty if the current lease was cancelled or if there was no lease in effect at the date of the agreement since the clause did not, in any way, prevent the development or utilization of the lands. Justice Hunt also concluded that the clause operated as a transfer of an interest to the trustee which vested on the date it was given, although enjoyment of it would be postponed to a later date.

The rule against perpetuities has also been considered in the context of "top leases." The Supreme Court of Canada has defined a top lease as "one which takes effect upon the termination of a prior existing lease."[89] The top lease encumbers the lessor's reversionary interest in the mines and minerals such that, upon the determination of the prior estate (the existing oil and gas lease), the rights in the mines and minerals granted therein revert to the lessor and the lessor is obligated to grant an interest in relation to them to the top lessee. A top lease can take a variety of forms. It can exist as a grant conditional upon the determination of the prior particular estate, as a right of first refusal that kicks-in upon the determination of the prior particular estate, or as an option that arises upon the determination of the prior particular estate. The top lease in *Taylor* would be characterized as the first type of top lease. The language of that top lease provided as follows:

> UPON AND IN THE EVENT OF the termination, cancellation, avoidance or expiration of the said drilling lease between the GRANTOR and the LESSEE, and in consideration of the covenants of the GRANTEE herein contained, the GRANTOR DOES HEREBY GRANT AND LEASE UNTO THE GRANTEE all the mines, minerals and mineral rights, including the petroleum, natural gas and all related hydro-carbons ... together with the exclusive right and privilege to explore, drill for, win, take, remove, store and dispose of, the minerals.[90]

The issue for the Court was whether or not the top lease offended the rule against perpetuities. The trial judge concluded that as the Saskatchewan legislature had debated but failed to pass perpetuities legislation, it must be taken to mean that in Saskatchewan, the rule against perpetuities applied and it was not open for the Court to make an exception on the basis that the rationale of the rule would not be offended. Instead, the Court determined that it had to apply the rule and the only question it had to answer was whether the top lease in question could be said to have vested in the holder of the top lease, or whether it remained a contingent interest:

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87 *Supra* note 82.
88 *Supra* note 3.
89 *Meyers Estate v. Freeholders Oil Co.*, [1960] S.C.R. 761 at 766.
90 *Supra* note 7.

> In deciding whether there has been a breach of the rule against perpetuities, the crucial determination is the time of vesting. To answer that question one interprets the contract by the ordinary rules of construction. The rule against perpetuities plays no role in that process. It is only after the time of vesting has been ascertained, that a determination can be made about whether that time is too remote and therefore in contravention of the rule.[91]

Unlike Hunt J. in *Galloway Estate*,[92] who was prepared to find that a covenant to reserve the royalty in future leases gave the trustees under the royalty trust agreements a vested interest in the royalty, postponed only as to possession, Gerein J. in *Taylor* was not prepared to hold that the interests of the top lessee had vested. He construed the language of the top lease strictly, noting that the "usual and ordinary meaning of the word 'upon' and the phrase 'in the event,' connote time and condition and not property or an interest in property."[93] He also noted the rule that a future interest could be considered vested if there is no condition precedent to its taking effect in possession other than the termination of the prior estate.[94] The language used by the parties, however, indicated to him that the termination of the prior estate was a condition precedent to vesting, rather than a vested interest postponed only as to possession.

Had the Saskatchewan Court of Appeal chosen to do so, it could have overturned the trial decision on the basis that the top lessee's interest in the top lease vested upon execution of the lease and was postponed only as to possession. Unlike some top leases, this particular top lease is not an option that the top lessee can exercise on the determination of the prior estate. The granting language of the particular lease in question could certainly be construed as a present grant. Instead, like the Supreme Court of Canada in *Dynex*,[95] the Saskatchewan Court of Appeal determined that it was the rule itself that had to be changed. As in *Dynex*, the industry context was of particular importance to the Court in *Taylor*:

> The concept of "top leases" is not unique or unusual in the Saskatchewan oil and gas industry. The evidence adduced at trial established that there are hundreds of such leases in this Province....
>
> In some jurisdictions "top leases" are considered accepted business practice in the oil and gas industry....
>
> Although "top leases" have been attacked on other grounds, this is the first case before the Saskatchewan Courts in which the rule against perpetuities has been advanced to void such a lease. The earlier litigation which was spawned by the discovery of oil in some of the areas covered by the "top leases" focused essentially on the grantors' pleas of *non est factum* [which were unsuccessful]....
>
> Given the fact that earlier litigation, even at the Supreme Court level, did not raise any issue over the rule against perpetuities, one can fairly assume that until recent times, practitioners in the field did not consider such "top leases" to be vulnerable.[96]

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91 *Ibid.* at 434.

92 *Supra* note 3.

93 *Supra* note 7 at 441, citing various dictionary meanings of these terms at 441-42.

94 *Ibid.* at 435-37, citing L.M. Simes, *Handbook of the Law of Future Interests*, 2d ed. (St. Paul: West Publishing, 1966) at 186.

95 *Supra* note 6.

96 *Supra* note 7 at 49-50.

Following a review of the history and development of the rule, as well as its object and purposes, the Court of Appeal agreed that the top lease did not offend the policy behind the rule, noting that it encouraged, rather than discouraged, commercial development and drilling activity on the land, and further noting that:

> Given the development of top leasing as a useful and desirable type of transaction in the oil and gas industry, the application of the orthodox rule against perpetuities does not reflect modern realities. When the rule was formulated by judges in earlier times, top leases in the oil and gas industry were not contemplated.
>
> It could not have been intended to apply to such transactions and no worthwhile social or economic purpose is served by applying it to this type of transaction in the oil and gas industry.[97]

The next question the Court asked was whether it was bound to apply the rule, even though the rationale for the rule was not offended by the practice of top-leasing. The Court noted that the Supreme Court of Canada had considered the rule in at least 28 cases, and in each case it merely applied the rule or considered whether the conveyance fell within the rule. In no case had the Supreme Court of Canada considered the "validity of the policy considerations that spawned the rule." Holding that the "socio-economic and political conditions which gave rise to the creation of the rule no longer exist," and in the absence of Supreme Court of Canada precedent prohibiting the Court from creating an exception to the rule, the Court considered it was open for them to do so.

Like the Supreme Court of Canada in *Dynex*, the Saskatchewan Court of Appeal also relied on cases involving the modification or abolition of judge-made common law rules and principles by other Canadian courts. In particular, the Court cited the following passage of La Forest J. in *Morguard Investments Ltd.v. De Savoye*,[98] where the Supreme Court of Canada determined that the restrictive rules concerning reciprocal enforcement of judgments had to be adjusted:

> The world has changed since the above rules were developed in 19th century England. Modern means of travel and communications have made many of these 19th century concerns appear parochial. The business community operates in a world economy and we correctly speak of a world community even in the face of decentralized political and legal power. Accommodating the flow of wealth, skills and people across state lines has now become imperative. Under these circumstances, our approach to the recognition and enforcement of foreign judgements would appear ripe for reappraisal.[99]

The Saskatchewan Court of Appeal also cited the Supreme Court of Canada's guidelines for "adjusting" the common law, set out in *R. v. Salituro*[100] where Iacobucci J., for the Court, stated that:

> [T]his Court has laid down guidelines for the exercise of the power to develop the common law. The common theme of these cases is that, while complex changes to the law with uncertain ramifications should be left to

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97 *Ibid.* at 66.
98 [1990] 3 S.C.R. 1077.
99 *Ibid.*, cited in *Taylor*, *supra* note 7 at 70.
100 [1991] 3 S.C.R. 654 at 660, 670 [*Salituro*].

> the legislature, the courts can and should make incremental changes to the common law to bring legal rules into step with a changing society....
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> ...
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> These cases reflect the flexible approach that this court has taken to the development of the common law. Judges can and should adapt the common law to reflect the changing social, moral and economic fabric of the country. Judges should not be quick to perpetuate rules whose social foundation has long since disappeared. Nonetheless, there are significant constraints on the power of the judiciary to change the law. As McLachlin J. indicated in Watkins, supra, in a constitutional democracy such as ours it is the legislature and not the courts which has the major responsibility for law reform; and for any changes to the law which may have complex ramifications, however necessary or desirable such changes may be, they should be left to the legislature. The judiciary should confine itself to those incremental changes which are necessary to keep the common law in step with the dynamic and evolving fabric of our society.[101]

In concluding that it would not apply the rule against perpetuities to the practice of top leasing in Saskatchewan, the Court concluded that an exception to the rule was required, holding that:

> The genius of the common law lies in its adaptiveness to changing times. Its basic principles were not meant to become rigid formulae, inflexible and resistant to new developments or changing concepts in the commercial world. Since common law rules are judge-made rules, the Court can make exceptions to such rules when changing conditions so mandate. Common law rules may be tweaked to do justice between the parties when a rigid and mechanistic application of a rule would run counter to the object and purpose of the rule.[102]

IV. THE IMPACT OF THE CHALLENGING METHOD OF INTERPRETATION

A. FUTURE APPLICATION OF THE CHALLENGING METHOD OF INTERPRETATION

There are certain commonalities between *Dynex* and *Taylor* that can help us to identify the approaches used by the Courts, the circumstances when we might expect other courts to apply the challenging method of interpretation and whether or not this will have an effect on traditional methods of interpretation. Based upon these cases, it is suggested that the following four elements will likely need to be present before a court will utilize the challenging method of interpretation: (1) long-standing industry practice; (2) the absence of definitive Canadian precedents; (3) favourable policy dictates; and (4) expediency.

1. LONG-STANDING INDUSTRY PRACTICE

The most significant factor relied upon by the two courts was the existence of long-standing industry practices, specifically that:

(a) industry participants had adopted and relied upon these practices and had created a set of expectations surrounding their creation, use and significance within the industry;

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[101] *Ibid.*, cited in *Taylor*, *supra* note 7 at 73-74.

[102] *Supra* note 7 at 86.

(b) the practices served to promote the development of Canada's oil and gas industry; and

(c) the practices arose in different social, industrial and legal contexts, the uniqueness of which were not contemplated at the time the relevant common law concepts or rules were developed.

These factors were well suited to the Supreme Court of Canada's previously expressed guidelines, in *Friedmann Equity Developments*[103] and *Salituro*,[104] for example, for the exercise of the Court's power to develop or adjust the common law to fit evolving societal requirements.

2. THE ABSENCE OF CANADIAN PRECEDENTS

The Courts, in both cases, noted the absence of definitive Canadian case law on point. In *Taylor*,[105] the matter was defined very narrowly. It was limited to Supreme Court of Canada decisions on point, and although the Supreme Court had certainly applied the rule against perpetuities in the past, it had not actually addressed the issue of whether or not it *should* apply the rule. This, coupled with the guidelines for exercise of the Court's power to develop the common law to evolve with society, constituted an "absence of precedents on point" sufficient to allow the Saskatchewan Court of Appeal to address the matter. It also seemed to be noteworthy to the Court that the Supreme Court of Canada had dealt with issues surrounding top leases but in no case did the issue of the rule against perpetuities arise. Interestingly, the Saskatchewan Court of Appeal did not cite *Flegal*,[106] an Alberta case that analyzed the application of the rule in a similar manner, albeit with less fanfare or concern about whether or not the Court had the authority to create a new exception to the rule.

The Alberta Court of Appeal and the Supreme Court of Canada in *Dynex*[107] did not define the absence of precedents quite so narrowly. The Courts looked for both an absence of cases on point as well as Canadian case law and other literature which, although not definitive, could be construed as supporting the proposition that overriding royalties can be interests in land. Although there are a number of Canadian cases that have held that particular overriding royalties did not constitute interests in land, the Court noted that these conclusions were based upon the language used by the parties to create the overriding royalty and did not address the fundamental underlying issue of whether they could create an interest in land.

3. FAVOURABLE POLICY DICTATES

In both cases, the Courts cited important policy reasons for their decisions. The Alberta Court of Appeal in *Dynex* cited a paper prepared by Eugene Kuntz, where he argued that *the law should provide a framework* within which unnecessary risks for those who invest or

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103 *Supra* note 73.
104 *Supra* note 100.
105 *Supra* note 7.
106 *Supra* note 82.
107 *Supra* note 6.

participate in oil and gas operations are removed.[108] Summarizing the discussion paper's position, the Alberta Court of Appeal noted that:

> The oil and gas industry has created new devices to meet the high risks of the enterprise. Included among the new devices are non-operating interests which are used to make the sharing of benefits of mineral ownership definite and certain, minimize taxes, make clear delegation of operating rights and make proper allocation of the risks and rewards of an operation without invoking many objectionable features associated with creating a conventional business association. Non-operating interests including royalty interests, overriding royalty interests, production payments, net profits interests and carried interests.
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> [Eugene Kuntz] pointed out that it is of great importance to the party acquiring a non-operating interest that such an interest be classified as a property interest and not a mere contractual right in order to guard against the consequences of possible financial difficulties of the granting party and to protect the interests against the rights of third persons generally.[109]

The Alberta Court of Appeal suggested that such a framework was already in place for dealing with royalties issued out of corporeal estates, such as a lessor's royalty. A royalty, after all, is a royalty: "To distinguish between these two forms of royalty is to place form over substance. Royalties, whatever their origin, should be subject to the same set of rules."[110]

The Supreme Court of Canada had an interesting take on this issue, citing, in support of its determination that the "appellant could not offer any convincing policy reasons for maintaining the common law prohibition on the creation of an interest in land from an incorporeal hereditament other than fidelity to common law principles,"[111] as if it were the appellants' obligation to convince the Court not to change the law.

Likewise, the Saskatchewan Court of Appeal in *Taylor* focused on policy reasons in support of its determination not to apply the rule:

> "Top Leases" are an accepted business practice in the area. They increase actual drilling and competitiveness because oil companies whose leases have been "topped" have a greater incentive to drill on leased lands.... Such leases are considered accepted business practice in other jurisdictions.... [The rule] could not have been intended to apply to such transactions and no worthwhile social or economic purpose is served by applying it to this type of transaction in the oil and gas industry.[112]

4. EXPEDIENCY

The Alberta Court of Appeal in *Dynex* alluded to the fact that expediency played a part in its determination of the issue.[113] However, it was apparent that in both cases, the

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108 E. Kuntz, "Classifying Non-Operating Interests in Oil and Gas" (Calgary: Canadian Institute of Resources Law, 1988).

109 *Ibid.* at 652.

110 *Ibid.* at 653.

111 *Ibid* at 161.

112 *Supra* note 7 at 66.

113 *Supra* note 6 at 651.

consequences of failing to uphold the long-established practices weighed heavily in the decision. As the Alberta Court of Appeal noted:

> [O]ne consequence of the ruling below, that overriding royalties are not interests in land, is that some oil and gas companies with leases encumbered by overriding royalties may be worth more to a bank holding those leases as security if the company is petitioned into bankruptcy and the leases sold free of the ORRs, than if allowed to continue operating and paying the ORRs. This could create problems if it led to otherwise unnecessary bankruptcies.[114]

The Supreme Court of Canada relied, in part, on the custom in the oil and gas industry that had developed as a basis for its determination.

The Saskatchewan Court of Appeal in *Taylor* also noted the consequences of its decision, stating that "evidence at trial indicated that there are hundreds of such leases in existence in Saskatchewan — leases that might run afoul of the orthodox rule notwithstanding the fact that parties and their successors relied upon them for fifty years."[115]

In short, the practicalities of the situations clearly supported the Courts' determinations, and in both cases, the practices as defined were sufficiently precise that the consequences of changing the common law (in this case, maintaining the *status quo* in the industry) seemed to be both an incremental change and one easily capable of assessment.

B. IMPLICATIONS FOR STRICT AND LIBERAL METHODS OF INTERPRETATION

Based on the above-noted elements, it may be that the circumstances in which the courts will apply the challenging method of interpretation to oil and gas law are fairly narrow. The requirement that there be an absence of Canadian precedent suggests that this method of interpretation is not likely to be applied to the interpretation of agreements that grant property interests. Indeed, having concluded that an overriding royalty granted by a lessee could constitute an interest in land, the Supreme Court of Canada held that whether or not a particular overriding royalty agreement had that effect was dependent upon the language of the document and the interpretation of that language based on the relevant case law. There would appear to be more scope for this type of analysis in cases involving the characterization of a property interest itself.

That being said, the courts' willingness to see industry practice or custom as a *source of law* almost certainly signifies that industry context and hence, the liberal method of interpretation, will play a larger role in the interpretation of industry contracts, whether they relate to property law concepts or contract law concepts. Lawyers and their clients will need to be somewhat more cautious about relying on earlier cases interpreting agreements on the basis of the strict method of interpretation — at least to the extent the results of those cases are contrary to what the parties (as reasonable industry participants) actually intended.

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114 *Ibid.* at 652.

115 *Supra* note 7 at 66.

The decision of the Supreme Court of Canada in *Cull*[116] suggests that even the habendum provisions of an oil and gas lease will not be immune from the application of the liberal method of interpretation, notwithstanding that there may be several cases that have been strictly interpreted to the contrary.

The courts now have three different types of interpretation they can apply to determine the rights and responsibilities of participants in the oil and gas industry. While this leaves us somewhat unsettled in advising our clients, it does permit us to be somewhat more legally creative. Oil and gas companies in western Canada have typically been loathe to settle their disputes through litigation, and they may be even more so now. The oil and gas industry in western Canada, after all, is a relatively small community. Many companies sit on both sides of the fence at the same time. Permission to be more creative means, on the troublesome side, that there is less certainty, but it also means, on the positive side, that there is less certainty — it all depends upon which side you are on at any particular time.

V. SOME FINAL THOUGHTS

Although the industry certainly needed both of these practices (the granting of overriding royalties as interests in land and top leasing) to be upheld by the courts, there are differences between these cases that should be noted.

One of the more striking differences between the analysis of the Supreme Court of Canada in *Dynex* and the Saskatchewan Court of Appeal in *Taylor* is that the Supreme Court of Canada seemed to be looking for policy reasons *not to change* the law; whereas the Saskatchewan Court of Appeal was looking for policy reasons *to change* the law. This seems to suggest that the Supreme Court of Canada may have expanded the circumstances pursuant to which judges may reappraise the common law beyond the guidelines set out in *Salituro*.[117]

One not so striking, but perhaps far more important difference involves the subject matter of these cases. The application of the challenging method of interpretation by the Saskatchewan Court of Appeal in *Taylor* seems desirable and persuasive. The application of the challenging method of interpretation by the Supreme Court of Canada in *Dynex*, while desirable and certainly supportive of industry practice, is much less persuasive. In particular, the Court's characterisation of the common law position as a "prohibition on the creation of an interest in land from an incorporeal hereditament" does not accord with the nature of real property interests. The common law does not "prohibit" the creation of an interest in land from an incorporeal hereditament. The fact that an interest in land cannot be created out of an interest that is only relational to land arises as a logical consequence of the *theory* of the nature and inherent characteristics of property that our society has adopted, rightly or wrongly.

A "theory" is a set of related propositions and the linkages or relationships between them. Theory provides us with a pattern of interpretation, supplies us with a framework in which concepts and events capture special significance, and allows us to interpret the larger

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[116] *Supra* note 26.
[117] *Supra* note 100.

meaning of an event.[118] Blackstone recognized this aspect of property law in the eighteenth century when he noted in *Perrin v. Blake* that:

> The law of real property in this country is now formed into a fine artificial system, full of unseen connections and nice dependencies, and he that breaks one link of the chain endangers the dissolution of the whole.[119]

In this respect, there is a distinction between the way in which the Supreme Court of Canada applied the challenging method of interpretation to the characterization of overriding royalties as interests in land in *Dynex* and the application of that method by the Saskatchewan Court of Appeal in *Taylor*, even though their analysis in these cases is similar. For while the identification of the nature of overriding royalties derives from the logical consequences of the theoretical construct of real property law, the rule against perpetuities does not. The rule against perpetuities is a "rule" of law in the sense that it does "prohibit" the creation of interests in land if the vesting of such interests is too remote. It was created by the courts to preserve the "public interest" by ensuring the land could not be tied up and withdrawn from commerce by a wealthy few. The rule against perpetuities does not "define" the nature of property, neither is it a necessary conceptual building block in the theory of real property. It operated to facilitate our society's transition from a feudal society where land was held by the few to a democratic society where land is now held by many. To the extent the "public interest" no longer requires the application of the rule, there seems to be no reason to apply it. We cannot so easily say the same thing about the nature of overriding royalties without "breaking a link" in our theoretical "chain."

This is not to suggest that the challenging method of interpretation should not be applied to the interpretation and application of real property laws. However, unless we are prepared to change the underlying theoretical foundations upon which real property law concepts are based, we may need to be somewhat more circumspect in this area of law than in any other. Although the characterization of overriding royalties as interests in land may seem like an incremental change capable of assessment, in fact, perhaps what we have done is weaken the utility and predictive value of the theory of real property and our ability to understand the relative significance of real property events. That, in the long run, may be neither incremental nor something that is today easily capable of assessment.

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[118] K.R. Hoover, *The Elements of Social Scientific Thinking*, 3d. ed. (New York: St. Martin's Press, 1984) at 40.

[119] (1769) 1 W.Bl. 672. Cited in J.H.C. Morris & W.B. Leach, *The Rule Against Perpetuities* (London: Stevens & Sons, 1956) at 30.