RECENT JUDICIAL DEVELOPMENTS OF INTEREST TO OIL AND GAS LAWYERS

EDWARD A. LEEW AND MICHAEL A. THACKRAY*

The purpose of this paper is to provide a brief review of recent Canadian judicial decisions of interest to oil and gas lawyers. The authors have surveyed Canadian case law in the areas of contract, creditors' rights, government regulation, freehold leases, land titles, surface rights, trusts and tax.

Le but de cet article consiste à donner un bref aperçu des récentes décisions judiciaires canadiennes qui intéressent les avocats spécialisés dans le domaine pétrolier et gazier. Les auteurs ont revu la jurisprudence canadienne dans les domaines du contrat, des droits des créanciers, de la réglementation gouvernementale, des baux francs, des titres fonciers, des droits de superficie, des fiducies et de l'impôt.

TABLE OF CONTENTS

* Thackray Burgess, Calgary, Alberta. Due to publishing constraints, this article has been substantially edited by the editors and is an abridged version of the original article which was prepared and presented by the authors at the 2002 Canadian Petroleum Law Foundation Jasper Seminar. The article as originally prepared and presented offered much greater detail and analysis of recent judicial decisions of interest to oil and gas lawyers, the authors having surveyed Canadian case law in the areas of contract, creditors' rights, government regulation, freehold leases, land titles, surface rights, trusts and tax. The authors would be pleased to provide an electronic copy of the unabridged original article upon request to mthackray@thackrayburgess.com.

I. CONTRACTS

A. *EAGLE RESOURCES LTD. V. MACDONALD*[1]

In a complex commercial transaction, the defendant sold all of his shares in his wholly-owned oil and gas company, Eagle Resources Ltd. (Eagle) to Erin Mills Capital Corporation. For closing purposes, the purchasers relied in part on an evaluation of the proven and probable reserves of the major properties owned by Eagle. The evaluation was prepared in 1990 by Sproule Associates Ltd. (the Sproule 90 Report), which valued Eagle's

[1] [2002] 1 W.W.R. 241, 2001 ABCA 264.

major properties at $31.2 million. Due to production declines, Sproule conducted an update evaluation on Eagle's Dina Pool prior to the closing (the Sproule 91 Report). The Sproule 91 Report indicated that the value of the pool had dropped to $7.46 million from the $20.7 million value of the Sproule 90 Report. The Sproule 91 Report was not provided to anyone outside Eagle prior to the closing. Post-closing, Eagle was not as valuable as anticipated. Once the existence and contents of the Sproule 91 Report became known, the lawsuit commenced. The issues were whether the defendant fraudulently represented the value of the assets to the purchasers of his shares or breached his agreement with the purchasers, therefore causing the purchasers to suffer damages.

At trial,[2] Hawco J. concluded that there had been a breach of the share purchase agreement, but that the breach did not cause the plaintiff to suffer damages. In addressing the issue of loss to the plaintiff, Hawco J. observed that "if the plaintiff establishes that the misleading material caused it to pay an amount it would not otherwise have paid, then it is entitled to be put in the position that it would have been in absent the misleading material or information."[3]

Justice Hawco determined that the plaintiff would have been entitled to the difference between the expected value represented in the Sproule 90 Report and the actual value paid for the shares had it relied on the valuation in the Sproule 90 Report. However, the Court concluded that the plaintiff did not rely on the Sproule 90 Report and its valuation of the Dina Pool, based on the fact that the purchase price paid by the plaintiff did not reflect the Sproule 90 Report's values. Since the purchase price was significantly lower than the $20.7 million valuation, the Court concluded that the plaintiff was aware that the information contained in the Sproule 90 Report was outdated and unreliable. As a result, Hawco J. determined that the plaintiff was not entitled to damages and the claim was dismissed.

In allowing the appeal, the Alberta Court of Appeal disagreed with Hawco J.'s decision for the quantification of damages. The Court stated that the plaintiff must be put in a position where there are no facts materially adverse to any asset. The Court found that Hawco J. misstated the "legal rule to calculate the measure of damages in contract."[4]

The Court determined that damages must instead be quantified based on what the defendant represented to the plaintiff, not merely what the plaintiff independently predicted. The Court directed a new trial limited to the valuation of contractual damages, instructing that damages were to be determined based on the value of the assets described in the Sproule 90 Report less the value indicated in the Sproule 91 Report.

The Court held that the representations made in the purchase and sale agreement elevated the Sproule 90 Report to a warranty. Since the decision suggests that representations concerning assets may be construed as information, opinions and views about those assets, or as warranties, sellers should ensure that all information provided to potential buyers is accurate and up-to-date.

---

2 [2001] 2 W.W.R. 346, 2001 ABQB 590.
3 *Ibid.* at para. 133.
4 *Supra* note 1 at para. 21.

B. *MUNRO V. CRISPIN ENERGY INC.*[5]

This case addresses the consequences of an employee's failure to object in a timely manner to salary reductions. It also addresses an employee's failure to take annual vacation and attempts to obtain compensation for accumulated time on termination of employment.

The plaintiff was hired as President and CEO of the defendant company on 18 April 1995, pursuant to a written employment contract between the parties. The contract stipulated that: (1) the term of employment would be from 18 April 1995 to 19 April 1998, at which time the employment "shall continue on such revised terms and conditions as may be established by the Board and agreed to" by the plaintiff; (2) the defendant would provide the plaintiff with a salary of $84,000 payable in semi-monthly payments of $3,500, subject to periodic review, and four weeks' annual paid vacation; and (3) if the defendant wished to change the position of the plaintiff, the plaintiff would have the option of terminating his employment within one year of the change, and the defendant would pay to the plaintiff an amount equivalent to twenty-four months' salary at the rate in effect at the time that the notice was given (amended by agreement in May 1998).[6]

A new President and CEO was hired in October 1998, and the plaintiff became Vice President, Engineering and Chief Operating Officer. In December 1998, salary reductions were effected and the plaintiff's salary was reduced from $7,000 per month to $2,750. The plaintiff resigned by letter effective 31 July 1999, and claimed that, *inter alia*, he was owed $168,000 pursuant to the May 1998 amendment to the employment contract and $24,675 of unpaid vacation pay.

The parties agreed that the plaintiff was entitled to receive an amount equivalent to twenty-four months' salary. However, the issue was the rate in effect at the time the notice was given. The plaintiff argued that he was never advised of the salary reductions, and that the determinative rate was $84,000 as stipulated in the employment contract, as it had never been amended. The defendant argued that the plaintiff's reduced monthly salary should serve as the basis for his severance pay.

The Court found in favour of the defendant. Justice Lomas held that when an employee continues to work following a salary reduction, he may be deemed to have accepted the employer's repudiation of the original terms of the employment contract. The duration of employment required to constitute acceptance was not decided. However, precedents reviewed by the Court suggested that continued employment for two months under a reduced salary may constitute acceptance.

The Court also made it clear that whether or not the employee is deemed to have accepted the reduction will depend on the type of notice provided to the employee. Courts will not automatically deem acceptance by the employee where no actual or constructive notice has been provided. However, constructive notice may be deemed where the reduction was apparent or where the employee is in a position to know about the reduction. Once the

---

5 2001 ABQB 279.

6 *Ibid.* at para. 3.

employee has knowledge of the reduction, he must object promptly to the change or he may be deemed to have accepted it.

Since the plaintiff was a director of the defendant, Lomas J. found that he had direct knowledge of the salary reduction. The Court also found that, given his knowledge, the plaintiff had a duty to object promptly to the salary reduction and to make his position known to the directors. The failure to object to the reduction proposals and to communicate his position clearly, followed by his continued employment for seven months following the reduction, resulted in the plaintiff's acceptance of the salary cuts. Therefore, the reduced salary was in effect at the time of the plaintiff's resignation.

Justice Lomas also dismissed the plaintiff's claim for the vacation pay that accrued between April 1995 and July 1999, as the plaintiff had not been able to accumulate holidays while working for a previous employer in the same industry. In addition, other witnesses testified that it was not industry practice to allow accumulation of holidays. The Court acknowledged the need for company policies restricting accumulation and dismissed the claim for unpaid holidays.

C. *AMBASSADOR INDUSTRIES LTD. V. KASTENS*[7]

This case reminds us about important common law principles in the context of "time is of the essence" clauses. While this case deals with a residential real estate contract, the principles are equally applicable to oil and gas agreements for purchase and sale.

On 28 March 1998, the plaintiff purchasers and defendant vendors entered into a contract for the sale of residential property, with a closing date of 30 September 1999 and a "time is of the essence" clause. The plaintiffs paid a deposit of $50,000. In July 1999, the defendants advised the plaintiffs that the closing date would have to be postponed from 30 September 1999, but no new closing date was established. In April 2000, the parties executed an amending agreement changing the completion and adjustment dates to 3 May 2000, with all other terms and conditions to remain the same. On 4 May 2000, the closing documents were delivered. The plaintiffs' solicitor gave notice to the defendants that, because the closing documents had not been returned by 3 May 2000, and because time was expressly of the essence under the contract, the plaintiffs had elected to terminate the contract.

The defendants argued that the "time is of the essence" provision was waived when the 30 September 1999 closing date passed. Since no new date for completion had been fixed, the law therefore implied a term that the sale would be completed within a reasonable time. As the defendants had delivered the documents within a reasonable time, the plaintiffs were bound to complete the transaction, and in light of the plaintiffs' failure to do so, the defendants were entitled to retain the deposit.

---

7 2001 BCSC 484.

Justice Wilson agreed with the defendants' arguments based on the precedents in *Shackleton v. Hayes*,[8] *Stickney v. Keeble*,[9] *Woels v. Mashinter*[10] and *Beks v. Share*.[11] These cases stand for the proposition that:

> once the original completion date has passed, the law will imply a term that the sale be completed within a reasonable time, and ... one party cannot unilaterally make time again of the essence by setting a new date for performance, at least without giving express notice that if the new date is not met, the party serving the notice will treat the contract as at an end.[12]

Justice Wilson concluded that the "time is of the essence" provision had been waived. If the plaintiffs wanted to reinstate the provision, they were required to notify the defendants. The notification should have stated that the plaintiffs would treat the agreement as at an end if the defendants did not meet the new date of completion. A provision stating that "all other terms and conditions remain the same" is not sufficient to constitute notice that time was of the essence. Since the plaintiffs did not provide any notification, the Court held that they could not rely on the "time is of the essence" provision.

Oil and gas vendors and purchasers should follow the procedure required to reintroduce the "time is of the essence" provisions in a contract following an extension of the initial closing date, and ensure that the "time is of the essence" clause is included in the extension agreement.

D. *CANADA SOUTHERN PETROLEUM LTD. V. AMOCO CANADA PETROLEUM CO.*[13]

This case addresses the assignment of contracts, the effects of novation on privity of contract and the types of contractual relationships that give rise to fiduciary and implied obligations. Specifically, it asks whether joint venturers or joint operators of a gas field owe a fiduciary duty to one another.

In 1959, the plaintiff Canada Southern Petroleum Ltd. (the CMO Group) and a group of petroleum corporations collectively known as the "HS Group," entered into a farmout agreement (the 1959 Agreement) which contained an express development and marketing covenant. The covenant provided that the HS Group would "assure the earliest feasible development and marketing of oil and/or gas found on the properties."[14]

In 1961, the HS Group assigned half of its interest in the properties to Pan American Petroleum Corporation (Pan Am). Pan Am agreed to be bound by all of the terms and provisions of the 1959 Agreement. In 1966, the CMO Group's working interest was converted by agreement from a 50 percent working interest to a 50 percent carried interest (the 1966 Agreement). In 1969, Pan Am assigned all of its interest to Amoco Canada

8 (1954), 4 D.L.R. 81 (S.C.C.).
9 [1915] A.C. 386 (H.L.).
10 [1976] 5 W.W.R. 79 (Alta. S.C.).
11 [1994] B.C.J. No. 83 (S.C.) (QL).
12 *Supra* note 7 at para. 18.
13 [2002] 1 W.W.R. 520 (Alta. Q.B.) [*Southern*]. The authors thank Michael McCachen of Duncan McCachen (Calgary, Alberta) for his assistance in briefing this case.
14 *Ibid.* at para. 2.

Petroleum Co. (Amoco Canada). Amoco Canada agreed to assume all of Pan Am's obligations under any agreements relating to the assigned assets, including the 1959 Agreement. In subsequent years, other working interests were transferred from the HS Group to Amoco Canada Resources Ltd. (Amoco Resources). For each assignment, Amoco Resources agreed to assume all of the obligations and to be bound by all of the terms and provisions of the 1959 Agreement. In 1977, partial working interests were also assigned by agreement to Columbia Gas Development of Canada Ltd. (Columbia) and Imperial Oil Resources Ltd. (later assigned to Esso) (the 1977 Agreements). The 1977 Agreements acknowledged the 1959 and 1966 Agreements.

Gas reserves were discovered, but were shut in due to low gas prices and a lack of markets (prior to 1986), and then due to equipment failure and a lack of markets (after 1986). The plaintiffs alleged a breach of the marketing clause. The issue before the Court was the legal mechanism, if any, by which the defendants had become obliged to market the gas reserves. The plaintiffs argued that, *inter alia*, the defendants were bound to perform this obligation because of an implied obligation or fiduciary duty to market in oil and gas ventures of this kind.

The Court concluded that privity of contract gives rise to all obligations expressed in a contract. As a result, every original member of the HS Group was held responsible for any contractual obligations arising under the marketing clause of the 1959 Agreement. The issue the Court then had to address was whether the assignment of the original interests maintained the obligation under the marketing clause.

Justice MacLeod followed the principle of assignment, set out by the Supreme Court of Canada in *National Trust Co. v. Mead*,[15] that only contractual benefits can be assigned to a third party, not contractual obligations. This applies even where the original party has consented to the assignment and when the assignee has expressly agreed in the assignment to perform the original signatory's obligations.[16] As a result, the Court concluded that the parties receiving their interest through an assignment from HS Group were not responsible for the obligations of the marketing clause unless a novation of the 1959 Agreement had occurred, thereby creating both a new contract between the original party and the assignee and privity between the parties.

The 1966 and 1977 Agreements provided an opportunity for novation and, therefore, privity of contract, between the defendant assignees and the plaintiffs. The Court concluded that the 1966 Agreement did not create a novation because the plaintiffs expressly reserved their rights against the members of the HS Group and never expressly discharged the original HS Group signatories. In the absence of a novation, the remaining party cannot enforce assigned obligations against the assignee alone. As a result, the plaintiffs were denied the ability to enforce the marketing clause against any defendants who were not privy to the original 1959 Agreement.

15 [1990] 2 S.C.R. 410.

16 *Supra* note 13 at para. 129.

However, the plaintiffs successfully argued that the 1959 Agreement was incorporated by reference into the 1966 and 1977 Agreements, thereby binding the assignees. Justice McLeod observed that the recitals of the 1966 Agreement expressly referred to certain parties as "assignee successors in interest." As a result, the Court concluded that those companies that signed the 1966 Agreement and that were assignees to the HS Group's interest were bound by the terms and conditions of the 1959 Agreement.

Justice McLeod also held that the signatories to the 1977 Agreement were bound by the terms of the 1959 Agreement because the contract expressly referred to it as an "existing agreement" and stated that the operations "shall be conducted in accordance with the existing agreements as hereby amended." As a result of the incorporation of the 1959 Agreement into the 1966 and 1977 Agreements, the Court concluded that privity of contract existed between the plaintiffs and the defendants Amoco Canada, Amoco Resources, Mobil Oil Canada, Ltd. and Columbia.

The Court rejected the plaintiffs' argument that the commercial context of oil and gas development creates an implied obligation to market even where there is no express covenant in the contract. Justice McLeod concluded that such a view is inconsistent with the Canadian jurisprudential approach, which looks only to the actual words of a document.[17] The Court also rejected the defendants' argument that the duration of the obligations in the marketing clause was time limited. There was no express or implied intention to limit duration in any of the Agreements. The Court concluded that the obligations in the marketing clause were part of the consideration the HS Group paid for the right to earn an interest in the lands. Unlike a one-time payment, it was a "continuing consideration" which remained outstanding until all of the gas found on the property was marketed.

The Court held that the scope of the obligation to market will depend on the express wording in the contract. Where the contract establishes an obligation to assure "the earliest feasible marketing," courts have interpreted "feasible" as including a commercial or profit element which requires "the balancing of all the economics and surrounding circumstances at the time a possible market presents itself."[18]

The plaintiffs further argued that a fiduciary relationship existed between the parties because the 1959, 1966 and 1977 Agreements created a joint venture in which each venturer owed a fiduciary duty to the others. The Court rejected this argument, and followed *Wonsch Construction Co. v. National Bank of Canada*[19] in concluding that, "while joint ventures may create fiduciary duties, not all obligations are fiduciary."[20] Justice McLeod noted that finding a fiduciary relationship where the parties are engaged in arms-length commercial transactions or agreements should be done with caution. Justice McLeod also noted that only in exceptional cases, such as where one party was in a position of power and influence, would the law impose a fiduciary relationship that the parties themselves did not make a term of their contract, either expressly or by implication.

17 *Ibid.* at para. 161.
18 *Ibid.* at para. 190.
19 (1987), 70 C.B.R. (N.S.) 318 (Ont. S.C.), aff'd (1990), 75 D.L.R. (4th) 732 (Ont. C.A.).
20 *Supra* note 13 at para. 211.

The plaintiffs also argued that the defendants owed them fiduciary duties as joint operators of the gas field. Justice McLeod concluded, however, that not all operators are fiduciaries to non-operators for all purposes. Although some of the duties of an operator are fiduciary (for example, accounting, expenditure and sales), not every duty is fiduciary. In order to determine whether a fiduciary duty has been imposed, the facts of the case must be examined. If a fiduciary duty exists, it must arise from the circumstances and terms of the agreement itself. The test used to determine whether a fiduciary duty exists was that established by the Supreme Court of Canada in *Frame v. Smith*[21] and *Hodgkinson v. Simms.*[22]

In *Frame*, Wilson J. stated that:

> Relationships in which a fiduciary obligation have been imposed seem to possess three general characteristics:
>
> (1) The fiduciary has scope for the exercise of some discretion or power.
>
> (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.
>
> (3) The beneficiary is particularly vulnerable to or at the mercy of the fiduciary holding the discretion or power.[23]

In *Hodgkinson*, the test was:

> whether, given all of the surrounding circumstances, one party could reasonably have expected the other party to act in their best interest with respect to the subject matter at issue. Discretion, influence, vulnerability and trust were mentioned as non-exhaustive examples of evidential factors to be considered in making the determination.... The existence of a fiduciary duty in a given csae will depend upon the reasonable expectations of the parties, and these in turn depend on factors such as trust, confidence, complexity of subject matter, and community or industry standards.[24]

In order to find a fiduciary duty, there must be evidence of a mutual understanding that one party has relinquished its own self-interest and agreed to act solely on the behalf of the other party.

Justice McLeod determined that the nature of the contractual obligations imposed by the 1959 Agreement could not give rise to fiduciary obligations. Since the plaintiffs were not vulnerable, the nature of the obligations imposed under the marketing clause were not sufficient to impose fiduciary duties on the defendants.

Having found that the 1959, 1966 and 1977 Agreements imposed marketing obligations on some of the defendants, the Court looked at whether those obligations had been breached. Justice McLeod emphasized the business judgment rule, which operates to shield business decisions that have been made honestly, prudently, in good faith and on reasonable grounds. After examining the evidence provided by experts, the Court concluded that best efforts were

---

21 [1987] 2 S.C.R. 99 [*Frame*].

22 [1994] 3 S.C.R. 377 [*Hodgkinson*].

23 *Supra* note 21 at para. 60.

24 *Supra* note 22 at paras. 32, 35.

made to market the gas and that the decisions of the defendants demonstrated sound business judgment.

E. *BOWLEN V. DIGGER EXCAVATING (1983) LTD.*[25]

This case deals with the principle of "time is of the essence," specific performance and return of a deposit.

The appellants (the Bowlens) entered into a Real Estate Purchase Contract with the respondent (Digger) on 21 February 1999:

> The contract contemplated a closing date of March 19, 1999, and included a standard time of the essence clause....
>
> At the Bowlens' request, Digger agreed to extend the closing date to April 19, 1999. The Bowlens delivered conveyancing documents to Digger's solicitor on April 13, 1999, on trust conditions. One of those conditions was "[t]hat notwithstanding any extension of time, time is and shall remain of the essence of this transaction."
>
> On April 19, 1999, Digger's solicitor sought and obtained an extension of the closing date to April 21, 1999. On April 20, Digger sought to make amendments to the Transfer of Land.... The Bowlens agreed to the amendments on the condition that cash to close be provided by April 21, 1999.... On April 21, 1999, the real estate agent for both parties attempted to contact the Bowlens' solicitor, seeking a further one-day extension on Digger's behalf. [The solicitor could not be reached, but the firm's paralegal stated that although she had no instructions, she did not foresee any problems.]
>
> Digger had not fully performed its obligations under the Contract by April 21, 1999. On April 22, 1999, the Bowlens' solicitor advised Digger's solicitor that no further extension would be permitted [and] that the contract was terminated.... Later the same day, Digger's solicitor advised that cash to close had been received and that Digger was prepared to proceed notwithstanding the purported termination of the Contract. When the transaction did not close, Digger filed an Originating Notice seeking specific performance of the Contract.
>
> The Chambers Judge concluded that it would be inequitable for the Bowlens to rely on the position that time was of the essence of the Contract and granted an Order for specific performance.[26]

The Chambers Judge based his conclusion on the following factors: (1) there had been two prior extensions of time; (2) the respondent kept the appellants informed of the steps it was taking to conclude the transaction; (3) the real estate agent had spoken to the paralegal in the office of the solicitor for the appellants; and (4) the requested extension was only one day.

The Court of Appeal overturned the order on a number of grounds. First, the respondent was not able to perform its contractual obligation to close on 21 April 1999. The party seeking specific performance must be in a position to show that it was ready, willing and able to perform the agreement on the stipulated date. Since the respondent neither tendered the payment due on the closing date, nor demonstrated that it was willing and able to do so, it

---

25 [2001] 11 W.W.R. 618 (Alta. C.A.).

26 *Ibid.* at paras. 2-8.

could not be granted specific performance. The Court noted that where the parties have stipulated that time is of the essence, the courts will generally not assist the party which has failed to perform on time.

Second, time remained of the essence following the extensions for closing. The Court noted that the mere fact that the parties previously agreed to an extension did not itself indicate a waiver of the "time is of the essence" clause. However, in this case, there was clear documentary evidence indicating that the extensions of time did not result in a waiver of the "time is of the essence" clause. The Court concluded that the short period of the requested extension and the fact that the appellants' solicitor kept the respondent informed of its progress were irrelevant considerations. Since the appellants never waived the clause in the extensions, it remained in full force and effect up to the date of closing.

The Court concluded that the "time is of the essence" clause had the effect of terminating the agreement when the respondent failed to provide the cash to close on 21 April 1999. In the absence of circumstances that would make it unjust or inequitable for a party to insist that time is of the essence, the extension deadline must be strictly adhered to if the agreement is to remain in effect. The Court should not intervene where the parties have expressly indicated that time is of the essence and the conditions relating to time have not been observed. However, the Court noted that one fundamental exception to this rule occurs where the evidence establishes that the terminating party had conducted themselves in an unfair or unjust manner.

The Court then examined the appellants' actions to determine whether there had been any misconduct. In order to prove misconduct, the Court found that "the party seeking relief must be in a position to show that the conduct of the other party misled him or caused him to act in a manner that resulted in an inability to perform the obligations that he would otherwise have been in a position to perform."[27] The Court failed to find any evidence of misconduct and, as a result, the appeal was allowed.

The respondent then sought relief from forfeiture of its deposit. The granting of relief from forfeiture depended on "whether the deposit was a genuine pre-estimate of damages or whether it was a penalty."[28] The Court held that a deposit will be considered a pre-estimate of damages where it compensates the vendor for the property being off the market and for the loss of bargaining power incident upon disclosing the price at which the vendor would be willing to sell. A deposit "become[s] a penalty when it goes beyond a genuine pre-estimate of damages and becomes, in whole or in part, a pre-payment of the purchase price.... Where a deposit can be characterized in law as a penalty, the loss may be subject to relief from forfeiture."[29] Since the deposit in this case was a mere 1.75 percent of the total purchase price, and the respondent failed to provide any explanation for its inability to tender the funds on 21 April 1999, the Court denied relief from forfeiture.

---

27 *Ibid.* at para. 24.

28 *Ibid.* at para. 31.

29 *Ibid.* at para. 35.

F. *INMET MINING CORP. V. HOMESTAKE CANADA INC.*[30]

This case discusses principles of rescission and repudiation in relation to contracts for purchase and sale. It also discusses the definitions of "material facts" and "material changes" for representations and warranties relating to assets.

Inmet Mining Corp. (Inmet) entered into a contract of purchase and sale with Homestake Canada Inc. (Homestake) to sell an open-pit gold and copper mine. Approximately two weeks before closing, Homestake terminated the contract, claiming that it had discovered non-disclosure by Inmet of material adverse facts, entitling it to rescind the contract.

Inmet, in turn, alleged that Homestake had had second thoughts about completing the contract due to falling gold prices, higher operating costs and lower exchange rates. As a result, it claimed that Homestake's termination was a repudiation, entitling Inmet to an order for specific performance or, alternatively, damages in the order of $86 to $110 million dollars.

The primary issue before the Court was whether the termination was a rescission or repudiation of the contract. Justice Satanove briefly reviewed the difference between rescission and repudiation:

> A contract is repudiated where one party, before the time fixed for performance, refuses to perform its obligations under the contract.... The innocent party has two options: it can accept the breach by bringing an action on the contract or notifying the other party; or it can refuse to accept the breach and continue to press for performance. Acceptance of the breach releases the innocent party from its obligation to perform. Non-acceptance of the breach obliges the innocent party to remain willing, ready and able to perform and allows it to claim specific performance.
>
> However, if the non-performing party refuses to perform because it did not get what it bargained for, it is not repudiating the Contract, but rather lawfully terminating or rescinding it....
>
> The existence of the right to rescind depends on the relevant terms of the contract, express or implied. If the other party has not fulfilled a condition precedent or has breached a fundamental term of the contract, or has misrepresented existing facts, then the terminating party may be entitled to rescission.[31]

The contract represented and warranted that Inmet had:

> provided to [Homestake] disclosure of all information in its possession or control relating to any material fact which could reasonably be expected to have a material adverse effect on the condition (financial or otherwise), operation or prospects of the business or the Purchased Assets as a going concern; additionally [Inmet had] provided to [Homestake] all interpretative reserve information in its possession or control pertaining to the purchased assets.[32]

---

30 (2002), 99 B.C.L.R. (3d) 93, 2002 BCSC 61.

31 *Ibid.* at paras. 39-41.

32 *Ibid.* at para. 24.

The contract also contained three conditions precedent: (1) "that no material or adverse changes had occurred with respect to the purchased assets"; (2) that Homestake had "reasonable access to the Purchased Assets ... to conduct further due diligence inquiries; and (3) that the results of the due diligence inquiries did not disclose "any material adverse fact[s] relating to (i) the Purchased Assets taken as a whole, or (ii) any asset comprised therein which may be of material value or importance to the operation of the Purchased Assets not disclosed prior to the date of the contract."[33]

As a result, the Court had to consider the definition of "material facts" and "material changes." Homestake argued that the test for materiality is wholly subjective, and that if the purchaser has an honest belief that the material fact would reasonably affect the financial or operational conditions or prospects of the business, then that subjective view governs.

Inmet argued that the test for materiality was objective/subjective. The Court agreed, stating that "The plaintiff rightly pointed out that if the test for materiality were wholly subjective, dependent only on the effect a fact had on the particular purchaser without an objective standard of reasonableness, the only issue in the proceeding would be the credibility of the purchaser."[34]

Justice Satanove applied the principles articulated in *TSC Industries Inc. v. Northway Inc.*,[35] *Dureau v. Kempe-West Enterprises Ltd.*,[36] *Hass v. Jung Nan Enterprises Ltd.*[37] and *Amirault v. Westminer*,[38] and observed that the standard will differ with the particular facts. If disclosure is legislated, the test is more objective because the legislation is designed to protect the public. However, because parties to a contract may tailor its terms, a purchaser can protect itself. In such cases, the courts will apply a "more subjective standard in determining 'what was material and adverse' to that purchaser's decision to buy."[39]

Justice Satanove noted that Homestake's knowledge had to be examined to determine whether all "material facts" had been disclosed, or whether a "material change" had taken place subsequent to the signing of the purchase and sale contract. Although Inmet had not disclosed a number of documents relating to the operation of the mine or the grade of the gold, the Court found that this was not conclusive that it was in breach of contract. In order to have a breach of contract, the information contained in the documents must relate to "a fact or change which was material or adverse to the purchaser in these circumstances."[40]

The Court stated that "[i]f a fact or information were already known to the defendant, or if the defendant did not rely on it, the failure of the plaintiff to disclose it or information related to it would be of no consequence to the defendant's decision to buy and therefore would not be material or adverse to the defendant."[41] The Court then examined the contents

---

33 *Ibid.* at paras. 32, 34.
34 *Ibid.* at para. 95.
35 426 U.S. 439 (1976).
36 [1989] B.C.J. No. 2123 (S.C.) (QL).
37 [1997] B.C.J. No. 127 (S.C.) (QL).
38 (1993), 120 N.S.R. (2d) 91, [1993] N.S.J. No. 129 (S.C.T.D.) (QL).
39 *Supra* note 30 at para. 127.
40 *Ibid.* at para. 129.
41 *Ibid.* at para. 128.

of each document that had not been disclosed to Homestake and compared the information with that already known through other means. Justice Satanove concluded that all of Homestake's allegations were unfounded. Inmet did not breach its disclosure obligations, nor did it fail to fulfill the conditions precedent. However, the Court did find that many of the alleged misrepresentations were, in fact, true. In addition, Homestake already knew much of the information contained in the undisclosed documents prior to signing the contract for purchase and sale. Further, the Court found that Homestake "did not rely on any of the statements allegedly made or omitted by Inmet when determining whether to buy the mine."[42]

The Court therefore concluded that Homestake's termination of the contract was a wrongful repudiation for which it was liable to Inmet, and that Inmet was entitled to either specific performance or equitable damages. The Court chose to award equitable damages in the amount of $88,200,000.

In April 2002, Inmet sought leave to re-open the trial and/or increase costs on the basis that the refusal of the Court to grant interest on the amount of equitable damages was an error of law. Leave was refused.[43]

G. *PREDATOR CORPORATION LTD. V. RICKS NOVA SCOTIA CO.*[44]

This decision interprets the provisions of a partnership dissolution agreement and discusses the application of the parol evidence rule when examining the commercial setting of the contract and ascertaining the intention of the parties.

On 1 January 2000, Predator Corporation Ltd. (Predator) and Ricks Nova Scotia Co. (Ricks) entered into a partnership agreement to explore, acquire and develop oil and gas properties. Pursuant to that agreement, the Predator Energies Partnership (the Partnership) acquired petroleum and natural gas rights, including parcels of land in the Ladyfern, British Columbia area. All Partnership interests in the Ladyfern prospects were, by agreement, transferred to Ricks.

On 1 December 2001, Murphy Oil Canada Ltd., Murphy Canada Exploration Ltd. (collectively, Murphy) and Apache Canada Ltd. (Apache) commenced legal proceedings against Ricks, Predator and the Partnership. They sought, among other remedies, a declaration of constructive trust in relation to all of the Ladyfern prospects.

On 21 December 2001, Ricks and Predator entered into a Dissolution Agreement pursuant to which all the assets and interests of the Partnership were to be distributed. All the assets forming part of the Ladyfern prospects were to be immediately transferred on an undivided basis, with 75 percent distributed to Ricks and the remaining 25 percent distributed to an independent third-party fiduciary to be held pending final resolution of the issue of ownership of such undivided 25 percent interest.

---

42 *Ibid.* at para. 419.
43 2002 BCSC 681.
44 2001 ABQB 1110.

On 21 January 2001, Ricks settled by conveying its undivided 75 percent interest in the Ladyfern prospects to Murphy. On 9 February 2001, Predator filed an Originating Notice against Ricks seeking a declaration that Predator was the legal owner of the undivided 25 percent interest in the Ladyfern prospects, and an order directing an assignment of that interest to Predator. On 28 February 2001, Ricks filed an Originating Notice against Predator, Murphy and Apache, requesting interpleader relief and seeking an order directing the appointment of a judicial trustee and an assignment of the undivided 25 percent interest to the trustee to be held and managed pending final resolution of the Murphy-Apache lawsuit.

The issues before the Court were: (1) whether there was any ambiguity in the provisions of the Dissolution Agreement; (2) the type of evidence that could be considered by the Court; and (3) the disposition that should be made of the 25 percent undivided interest. Predator and Ricks disagreed about the meaning of the words "issue of ownership" within the Dissolution Agreement. Predator argued that the "issue of ownership" required only that Ricks continue holding the legal interest until such time as Predator could qualify for registration of that interest in British Columbia. Ricks' position was that, since the parties could not agree upon an independent third-party fiduciary, and the Dissolution Agreement did not provide any mechanism to assign the interest to a trust in the event of a disagreement, it should be entitled to interplead the trust interest to a judicial trustee until the outcome of the litigation was determined.

Justice Wilkins emphasized the need to ascertain the intention of the contract based on the language used in the agreement and the circumstances in which it was written. In examining the context of the document, Wilkins J. followed the parol evidence rule set forth in *Paddon-Hughes Development Co. v. Pancontinental Oil Ltd.*[45] Although extrinsic evidence cannot be used by the courts to determine the intentions of the parties, the commercial setting of the agreement is not considered parol evidence and may be examined.

To interpret the meaning of the Dissolution Agreement, the Court examined the circumstances surrounding the execution of the document and concluded that there was no ambiguity in the words chosen by the parties. As a result, the Court excluded all extrinsic evidence from consideration; only affidavits and evidence of the commercial setting faced by the parties when they executed the Dissolution Agreement were admissible. The Court agreed with Ricks' position. Direct testimony or affidavit evidence from the parties indicating their understanding of the meaning of the words or their reason for utilizing the words was not admissible, but letters suggesting the intention of the parties were. Justice Wilkins then considered a letter sent on behalf of Predator, which suggested the meaning of the words "issue of ownership." The Court held that the letter confirmed its previous finding that "issue of ownership" meant the Murphy-Apache lawsuit.

The Court therefore concluded that the undivided 25 percent interest must be held in trust by a fiduciary pending final resolution of the Murphy-Apache lawsuit. Since the parties to the Dissolution Agreement could not agree upon an independent third-party fiduciary, the Court appointed a judicial trustee and granted the interpleader application.

---

[45] (1998), 223 A.R. 180 at para. 72, 1998 ABCA 333.

It is interesting to note that Wilkins J. did not refer to the Alberta Court of Appeal's decision in *Gainers Inc. v. Pocklington Finanicial Corp.*[46] In that case, the Court held that parol evidence about the understanding, intent, belief and knowledge of the parties is not admissible, especially where the documentary evidence is long, elaborate and formal. The Court of Appeal warned that the guise of context should not be used to evade the parol evidence rule, as the improper admission of such evidence can swell trials on simple issues.

H. *ALLIED CANADIAN ACQUISITION CORP. V. 1012689 ONTARIO LTD.*[47]

It is a well-settled principle of the common law that there is an implied condition that parties will act in good faith and use their best efforts to fulfill conditions precedent to a contract.[48] What remains in dispute, however, is whether the concept of "best efforts" imports a higher standard than "reasonable effort."[49] This case partially addresses this issue by discussing what constitutes "reasonable conduct" where there is a condition precedent.

The parties entered into a real estate purchase contract, which provided that acceptance was conditional upon the plaintiff purchaser conducting due diligence within thirty days from the date of acceptance. Due diligence included reasonable access to the property for environmental tests and inspections on the property during business hours. The contract also provided that if the plaintiff was not satisfied as a result of its due diligence, it could terminate the agreement by notice in writing to the defendant vendor delivered before the expiry date of the conditional period. The defendant would then return all monies paid by the plaintiff.

Prior to the expiration of the thirty-day conditional period, the plaintiff requested an extension of the conditional period to raise financing. The defendant refused to extend the conditional period, but offered to extend the closing date if a non-refundable deposit was paid. The plaintiff refused to pay the additional deposit and exercised its right to terminate the agreement. The plaintiff then sued for the return of the original deposit.

Justice Pitt concluded that the plaintiff had failed to act in good faith. The Court found that the plaintiff had relied on the due diligence clause as a means to convert the agreement of purchase and sale into an option. The Court noted that the law imposes an obligation on parties to exercise their discretion reasonably and to act honestly and in good faith in fulfilling the conditions precedent to a contract. However, the standard for determining whether those obligations have been fulfilled depends on the circumstances of the case.

The Court applied the precedent set in *Greenberg v. Meffert*,[50] which discussed the standards to be applied in determining whether obligations under conditions precedent have been exercised in good faith. In that case, the Ontario Court of Appeal suggested that

---

46 (2000), 81 Alta. L.R. (3d) 17 (C.A.).

47 (2002), 48 R.P.R. (3d) 43 (Ont. S.C.J.), 2002 CarswellOnt 212 (eC).

48 See *Dynamic Transport Ltd. v. O.K. Detailing Ltd.*, [1978] 2 S.C.R. 1072; *BEM Enterprises Ltd. v. Campeau* (1980), 24 B.C.L.R. 244 (S.C.); *Fraser v. Van Nus* (1985), 67 B.C.L.R. 285 (C.A.); *Combined Enterprises Ltd. v. Marall Homes Ltd.* (1995), 46 R.P.R. (2d) (B.C.S.C.).

49 See *Atmospheric Diving Systems Inc. v. International Hard Suits Inc.* (1994), 89 B.C.L.R. (2d) 356 (S.C.).

50 (1985), 50 O.R. (2d) 755 (C.A.).

contractual provisions which made performance subject to the discretion, opinion or satisfaction of a party fell into two categories. Where matters involve taste, sensibility, personal compatibility or judgment of the party for whose benefit the authority was given, the courts will impose a subjective standard of review. If matters relate to operative fitness, structural completion, mechanical utility or marketability, an objective standard of reasonableness will be imposed. In any given transaction, the category into which a provision falls will depend upon the intention of the parties as disclosed by the wording of the contract.

The Court held that the plaintiff was required to act in a demonstrably reasonable manner. In using the due diligence provision to opt out of the contract, the Court held that the plaintiff failed to do so and, therefore, the Court dismissed the plaintiff's application.

I. *MARSHALL V. BERNARD PLACE CORP.*[51]

This case discusses the standard of review used to determine whether a party acted reasonably, honestly and in good faith when attempting to fulfill a discretionary condition precedent to a contract. This case also addresses sole discretion clauses, which are typically found in agreements of purchase and sale for oil and gas assets.[52]

The plaintiffs signed an agreement to purchase a residence from the defendant for $1,510,000 and paid a deposit of $150,000. The agreement was conditional upon the plaintiffs obtaining a home inspection and a report that needed only to be "satisfactory to him in his sole and absolute discretion." The report described the house as well built and above average, but it also identified deficiencies in construction, condition and design that, for the most part, could be remedied at minor cost. After considering the report, the plaintiffs decided not to waive the condition and requested the return of their deposit. The defendant refused, and this action ensued.

The issues before the Ontario Court of Appeal were: (1) the requisite standard for the exercise of discretion under the sole discretion condition for inspection; (2) the onus for demonstrating compliance with the requisite standard; and (3) the availability of relief from forfeiture where the Court concludes that the requisite standards were not met.

The Court held that contractual conditions subject to discretionary judgments must be exercised honestly and in good faith. The plaintiffs met this standard because the inspection report identified legitimate uncertainties and inconveniences that they were entitled to take into account. The good faith requirement applies whether the exercise of the discretion is measured on an objective or a subjective standard. Whether a discretionary condition imposes a subjective or an objective standard depends on the intention of the parties as disclosed by the terms of their contract.

In this case, the Court found that the subject matter of the agreement attracted elements of both an objective and subjective standard of reasonableness. There is a tendency by the

---

51 (2002), 58 O.R. (3d) 97, 2002 CarswellOnt 404 (C.A.) (eC).

52 Sole discretion clauses, which form conditions precedent in oil and gas transactions, typically state that the "Purchaser shall be satisfied, acting in its sole and absolute discretion, on or before Closing, that the Tangibles are in good and operable condition."

courts to require the discretion or dissatisfaction to be reasonable, absent express contractual language or a clear indication from the type of contract or nature of the subject matter. The Court determined that an inspection report identifying deficiencies in construction provided an objective basis on which to assess the potential exercise of discretion under the property inspection condition.

However, the Court also found that if such objective factors exist, the language of the condition will then establish the latitude that should be given to the party seeking to rely on the condition in determining whether the risks associated with the identified deficiencies are acceptable in the circumstances. Thus, although an objective standard exists, the wording of the condition may also import a subjective element into the standard of review. It is the intention of the parties as disclosed by their contract which determines whether a discretionary condition imposes a subjective or objective standard.

In this case, the Court concluded that the sole discretion inspection condition imported a significant subjective element into the exercise of the discretion conferred under the condition. The Court found that the plaintiffs' decision was motivated by subjective considerations of personal compatibility and was based on their judgment pursuant to the authority given to them in the sole discretion clause. The plaintiffs had therefore met the requirements of good faith, honesty and reasonableness required to terminate an agreement under a condition precedent. The onus was on the defendant to prove that the plaintiffs had acted in bad faith and had not met the requirements necessary to support their exercise of discretion. The $150,000 deposit was ordered to be returned.

J. *EASTERN CANADIAN COAL GAS VENTURE LTD. V. CAPE BRETON DEVELOPMENT CORP.*[53]

This case deals with the principle of mistake in contract law. Eastern Canadian Coal Gas Venture Ltd. (Venture) and Cape Breton Development Corp. (Devco) entered into a coal gas agreement and a memorandum of understanding to produce and sell electricity. The agreement specified the use of gas from Devco's Phalen Colliery only. Devco was also to contribute $1.2 million in capital to the projected $6.2 million cost of the project. At the time the agreements were entered into, a feasibility study was available to the parties. The report was ambiguous, suggesting both that Phalen gas alone could and could not support the project. Devco decided not to proceed with the project on the basis that the Phalen Colliery could not produce sufficient gas. This action was subsequently commenced by Venture.

The Court found that both parties became involved in the project because of their mutually mistaken belief that Phalen gas alone could fuel the project. Justice Edwards noted that a mutual mistake at common law voids the contract. Venture argued that the mistake in this case was not a matter of fact essential to the agreement and, therefore, should not have the effect of nullifying the agreement. It also argued that unless the mistake formed an integral or essential element of the subject matter, or unless it was of such quality as to make the subject matter of the contract different from what it was believed to be, the contract should stand.

---

[53] (2001), 200 N.S.R. (2d) 201, 2001 NSSC 196.

The Court disagreed and held that the mutual mistake went to the foundation of the agreement, entitling Devco to terminate its involvement without any liability to Venture.

K. *KNIGHT V. EXPLORATION INNOVATIONS INC.*[54]

This case involves the evaluation of conditions precedent in a contract. The parties entered into a conditional contract, which stated that the conditions were for the sole benefit of the defendant and could be waived only by the defendant in writing. The conditions were: (1) written approval of the contract by the board of the defendant by 31 December 1997; (2) written regulatory approval of the contract by 19 December 1997; and (3) closing of another acquisition.

On 8 January 1998, only one of the conditions had been satisfied; the other two had not been waived in writing. The plaintiffs took the position that the contract was void on the basis that the contract was a conditional agreement subject to true conditions precedent. Since the conditions had not been satisfied nor waived in a timely fashion and in writing as required, the plaintiffs argued that the contract never came into existence. The defendant sought a declaration that the contract was valid and enforceable and an order for specific performance.

Justice Gallant confirmed the principles of true conditions precedent cited in *Kempling v. Hearthstone Manor Corp.*[55] and *Wiebe v. Bobsien.*[56] True conditions precedent that are not satisfied result in the contract never becoming effective so that the agreement is void and therefore not subject to breach. In order to determine the nature of the conditions in question, the Court reviewed the terms of the contract, the surrounding circumstances and the actions of the parties.

Justice Gallant concluded that the conditions of the contract were not true conditions precedent. The contract clearly expressed that the conditions were inserted for the sole benefit of the defendant and that only the defendant had the right to waive them. The wording of the contract also clearly anticipated that the conditions may have never been satisfied. The Court also noted that the contractual ability to waive is inconsistent with the creation of a true condition precedent, because true conditions precedent cannot be unilaterally waived.

Since the conditions in the contract were not true conditions precedent, the contract was not automatically void. However, the contract was rendered invalid and unenforceable because the plaintiffs repudiated the contract in writing and the defendant, by its conduct, elected to treat the contract as terminated.

---

54 2002 ABQB 21.

55 (1996), 137 D.L.R. (4th) 12 (Alta. C.A.).

56 (1985), 14 D.L.R. (4th) 754 (B.C.S.C.), aff'd (1986), 20 D.L.R. (4th) 475 (B.C.C.A.).

II. CREDITORS' RIGHTS

A. *BANK OF MONTREAL V. DYNEX PETROLEUM LTD.*[57]

This case is dealt with in some detail by Alicia Quesnel in her article "Modernizing the Property Laws that Bind Us,"[58] published in this issue.

Briefly, the Supreme Court of Canada recognized the need to change the common law, as there were no compelling policy reasons to maintain the common law prohibition on the creation of an interest in land from an incorporeal hereditament. The Court found that "a royalty, which is an interest in land, may be created from an incorporeal hereditament … if that is the intention of the parties."[59] The Court also noted that some common law concepts are inapplicable in the unique context of the oil and gas industry and its practices and that, in some cases, incremental changes to the common law may be necessary.

B. *NESI ENERGY MARKETING CANADA LTD. (TRUSTEE OF) V. NGL SUPPLY (GAS) CO.*[60]

The parties entered into a master agreement providing for the future delivery of gas. The gas was never delivered by the vendor, causing the purchaser to obtain gas from alternative sources at a price higher than that stipulated in the original contract. Since the gas was purchased in a rising market, the profits of the purchaser were reduced upon resale. This case discusses the issues of set-off and the netting of separate contracts under a master agreement. In a lengthy decision, the Alberta Court of Appeal concluded that the wording of the master contract and the circumstances of the case prevented netting or set-off from applying.

The appellants NGL Supply (Gas) Co. Ltd. (NGL) and Direct Energy Marketing Ltd. (Direct), and the respondent NESI Energy Marketing Canada Ltd. (NESI), were natural gas brokers in the business of buying and selling natural gas for future delivery. As the Court stated: "NGL and Direct each entered into a master agreement with NESI, which set the general terms that would form part of subsequent contracts between them. Direct and NGL concluded a number of these separate contracts with NESI under the master agreements," both for the purchase and sale of gas.[61] However, in late 1996, NESI experienced financial difficulties and became unable to honour its commitments under several of the contracts. After NESI was petitioned into bankruptcy, NGL and Direct filed proofs of claim for losses arising from NESI's failure to sell them gas at the agreed prices. As a result of that failure, they were forced to buy gas on the open market at higher prices, resulting in a loss of profit during resale. Those losses formed the basis of the claim.

It is important to note that Direct and NGL suffered no losses because NESI failed to purchase gas from them, as they were able to sell the natural gas originally destined for NESI at a higher price on the open market. The trustee in bankruptcy took the position that the

---

57 (2001), 208 D.L.R. (4th) 155, 2002 SCC 7.
58 See (2003) 41 Alta. L. Rev. at 159.
59 *Supra* note 57 at para. 21.
60 (2001), 201 D.L.R. (4th) 419, 2001 ABCA 168.
61 *Ibid.* at para. 1.

appellants' claims for loss should be reduced by the value of the profits arising from NESI's breach.

The Chambers Judge agreed with the Trustee and ordered a netting out of all contracts, compelling the appellants to reduce their claim for loss by the amount of the gains arising from NESI's default.[62] The appellants appealed on the basis that the Chambers Judge misinterpreted the master agreements and erred in his application of mitigation principles. The Court of Appeal agreed and allowed the appeal.

The first ground of appeal was whether the purchase and sale transactions under the master agreements were distinct and independent contracts. Justice Conrad, for the Court, concluded that the transactions were distinct, stating that "mere agreement on standard terms to be used did not alter the individual nature of the contracts governing each purchase and sale transaction."[63]

The second issue was whether the master agreements between the parties contemplated a netting of profits and losses upon NESI's default. The Court held that since the parties could have provided for netting in the contract but did not do so, the Court would not change the terms of the agreement by requiring the appellants to reduce their claims.

The third issue was whether the common law rules of avoided loss, indemnity or collateral loss entitled the trustee to reduce the appellants' claims. The Court concluded that those common law rules were not applicable because they involve mitigation of damages resulting from the breach of a single contract: "They do not operate to diminish losses resulting from the breach of one contract by deducting gains resulting from the breach of another contract."[64] The advantages gained by the appellants from NESI's default did not flow from their mitigation efforts. In the absence of an agreement between the parties, the Court held that it could not expand the application of mitigation principles. Bankruptcy does not provide a sufficient reason to link distinct transactions for the purpose of calculating damages. As a result, the Court held that NESI was not entitled to benefits arising from its breach of other distinct contracts.

The final issue was whether this was an appropriate case for set-off. The Court concluded that it was not. Set-off requires the existence of a cross-claim, and NESI had not advanced any claim against the appellants. It was not a case where a trustee refused to perform disadvantageous contracts and, at the same time, tried to enforce advantageous contracts with the same party.

62 [2000] 3 W.W.R. 294 (Alta. Q.B.); supplemental reasons at [2000] 3 W.W.R. 320.
63 *Supra* note 60 at para. 5.
64 *Ibid.* at para. 7.

C. *NATIONAL BANK OF CANADA V. MERIT ENERGY LTD.*[65]

This was an application in which purchasers of flow-through common shares in Merit Energy Ltd. (Merit) requested recognition as an ordinary creditor of the company to prevent the subordination of flow-through shareholders to the claims of unsecured creditors. The flow-through shareholders alleged that Merit made misrepresentations in the prospectus and breached the subscription and renunciation agreements. Merit originally intended to reimburse purchasers of flow-through shares by obtaining Canadian Exploration Expenses (CEE) in an amount equal to the aggregate purchase price paid by each purchaser. Merit did not obtain CEEs as anticipated, and only $4 million of an anticipated $15 million was renounced to the flow-through shareholders prior to Merit being placed in receivership. This left an estimated $11 million shortfall. The flow-through shareholders claimed a right to damages or rescission as shareholders under securities legislation, and a right to damages for breach of an indemnity provision as debtholders.

Justice LoVecchio held that the claims advanced by the flow-through shareholders were, in substance, shareholder claims. Justice LoVecchio applied the decision of Romaine J. in *Re Blue Range Resource Corp.*,[66] where shareholders sought damages for misrepresentation in the amount of their investment following company insolvency. In that case, Romaine J. held that where a claim is in substance a shareholder claim for a return of an equity investment, it is subordinate to the claims of unsecured creditors. The basic common law principle is that shareholders rank after creditors in respect of any return on their equity investment. Justice LoVecchio then summarized the four important policy reasons described by Romaine J. to justify the absence of priority:

(i) the claims of shareholders rank behind the claims of creditors in insolvency;

(ii) creditors do business on the assumption that they will rank ahead of shareholders in the event of their debtor's insolvency;

(iii) shareholders are not entitled to rescind their shares on the basis of misrepresentation after the company has become insolvent;

(iv) to allow the shareholders to rank *pari passu* with the unsecured creditors could open the floodgates to aggrieved shareholders launching misrepresentation actions.[67]

Justice LoVecchio concluded that the claim of the flow-through shareholders was, in substance, a claim in equity, based on the facts that: (1) the shareholders' claim for rescission or damages for misrepresentation was derived from their status as Merit shareholders; and (2) essentially, the shareholders sought to recoup their investments.

As in *Re Blue Range Resource Corp.*, the "very core" of the shareholders' claim arose from the circumstances surrounding the acquisition of Merit shares. The flow-through shareholders had no cause of action until they acquired the shares. In addition, the damages claim included a direct claim for the return of capital, which would enable them to recover the purchase price of the shares. Since the Court concluded that the flow-through

---

65 [2001] 10 W.W.R. 305, 2001 ABQB 583.

66 (2000), 15 C.B.R. (4th) 169 (Alta. Q.B.).

67 *Supra* note 65 at para. 26.

shareholders' claim was in substance a claim for the return of their equity, that claim was subordinate to those of unsecured creditors.

It should be noted that the claims of the underwriters, directors, officers and trustee of Merit were coupled with the flow-through shareholders' claim. These other claims were successful. Justice LoVecchio concluded that these claims were entitled to rank with Merit's other unsecured creditors because their claims were based on contractual indemnities given by Merit for good and valuable consideration.

D. *IMC CANADA LTD. V. ENRON CANADA CORP.*[68]

In this case, an injunction was sought by IMC Canada Ltd. (IMC) to restrain Enron Canada Corp. (Enron) from demanding payments owing under swap transactions. IMC and Enron entered into a master agreement to govern future natural gas swap transactions, and both parties provided irrevocable standby letters of credit to support their potential indebtedness. IMC became indebted to Enron in the amount of $2,311,205 for payments under three specific swap transactions covered by the master agreement. When Enron demanded payment, IMC responded by stating that it considered Enron to be in default of the master agreement by virtue of the bankruptcy proceedings facing Enron. IMC then brought this application for an injunction restraining Enron from demanding payment pursuant to the letter of credit.

IMC argued that it should not be obligated to pay any money pursuant to the letter of credit because its ability to recover any funds improperly claimed would be irreparably harmed if Enron were to become insolvent. IMC further argued that it had met the three-stage test outlined in *RJR-MacDonald Inc. v. Canada (A.G.)*[69] that must be satisfied before an interlocutory injunction will be granted. Enron urged the Court to exercise its discretion against the motion given that IMC had provided extremely limited notice. It also asked the Court to take note that a decision to grant the injunction would impact "hundreds or thousands" of similar contracts.

The Court refused to exercise its discretion to grant the injunction. In dismissing the application, Wilkins J. concluded that "the granting of this relief had the potential to seriously disrupt the contractual rights and obligations of counterparties in this commercial arena to such an extent that this interlocutory Order was not appropriate."[70] The Court adopted the position taken by Hart J. in an earlier application brought by Enron, where Hart J. stated that "[The Court] must also have regard for the sanctity of contract and the detrimental effect which the order sought could surely have upon its counterparties who have bargained for and secured vested contractual rights to protect themselves in these risky, highly volatile commodity markets."[71] The Court also refused to grant the injunction on the basis that IMC had failed to establish irreparable harm and its entitlement on the balance of convenience test.

---

68 (2001), 30 C.B.R. (4th) 213, 2001 ABQB 1121.

69 [1994] 1 S.C.R. 311.

70 *Supra* note 68 at para. 30.

71 *Ibid.*

E. *574095 ALBERTA LTD. V. HAMILTON BROTHERS EXPLORATION CO.*[72]

This case addresses issue estoppel and cause of action estoppel in the context of a royalty agreement. The plaintiff alleged that it had paid the defendants $18 million more than it should have under the terms of a 22 year old royalty agreement. The basis of the alleged overpayment was that certain gas processing and marketing costs were permissible deductions and accordingly should have been continuously applied in the calculation of the royalty.

The royalty agreement had been the subject of two previous actions between the same parties. As a result, the defendants argued that the principle of *res judicata* applied and sought to strike the statement of claim. They claimed that although the cause of action on its face may be different, the underlying components were the same as those previously argued. The plaintiff argued that the doctrine of *res judicata* should be narrowly construed because it could deprive a litigant of their fundamental right to court access. The plaintiff also argued that the issues were different from those argued in previous litigation, and that the issue of whether it would have been a good idea to have brought the action earlier or to have joined it with a previous action is irrelevant because a party is not obligated to bring a counterclaim at the time it files its defence.

The Court first considered issue estoppel. The principles of issue estoppel were defined in *Danyluk v. Ainsworth Technologies Inc.*:

> When a question is litigated, the judgment of the Court is a final determination as between the parties and their privies. Any right, question or fact distinctly put in issue and directly determined by a Court of competent jurisdiction ... cannot be re-tried in a subsequent suit by the parties or their privies, though for a different cause of action.[73]

Issue estoppel therefore applies to rights, questions or facts distinctly put in issue and directly determined in earlier proceedings. The test for determining whether issue estoppel arises was set forth in *Angle v. Minister of National Revenue*:

> 1. Has the same question been decided?
> 2. Was the judicial decision which is said to create the estoppel final?
> 3. Were the parties to the judicial decision the same persons as the parties to the proceedings in which the estoppel is raised?[74]

The Court concluded that the present question had neither been put in issue nor determined by the previous decisions. In this case, the plaintiff was asking the Court to determine whether costs incurred after production is brought to the surface are deductible having regard to the definition of "value" in the royalty agreement. Previous litigation had answered the question of permissible deductions according to the definition of "burdens" and

---

72 2002 ABQB 238.

73 (2001), 201 D.L.R. (4th) 193 at 206 (S.C.C.).

74 (1974), 47 D.L.R. (3d) 544 at para. 33.

"deductions" in the royalty agreement, but the definition of "value" and its effects on permissible deductions had not been considered.

The Court next addressed cause of action estoppel. The applicable principles are summarized in *Abacus Cities Ltd. v. Bank of Montreal*:

> the court requires the parties to that litigation to bring forward their whole case and will not (except under special circumstances) permit the same parties to open the same subject to litigation in respect of a matter which might have been brought forward as part of the subject in contest, but which was not brought forward only because they have from negligence, inadvertence or even accident omitted part of their case.[75]

The question to be determined in evaluating whether cause of action estoppel applies is whether the plaintiff could have and should have put these matters in issue in the previous litigation. The plaintiff must show why, with reasonable diligence, the claim could not have been brought forward during the previous litigation. Justice Hawco concluded that cause of action estoppel did not apply in this case, as the issue of "value" was separate and distinct from the previous causes of action.

Furthermore, the Court refused to grant an order of estoppel on the basis that a party is not required to join, by way of counterclaim, a separate and distinct cause of action. Although a party must put forth all of its defences and should not be allowed to re-litigate the same issue, the Court stated that, "unless that very same issue has been determined, another party should not be prevented from having it determined, even if it may have been more conveniently dealt with previously."[76]

The Court concluded that the principle of *res judicata* should be narrowly and reluctantly applied and, therefore, refused to hold that the plaintiff was estopped from advancing its claim.

III. GOVERNMENT REGULATION

A. *GULF CANADA RESOURCES LIMITED V. ALBERTA*[77]

The Alberta Energy and Utilities Board (AEUB) concluded that continued production of associated gas presented a significant risk to future bitumen recovery from the Gulf-Surmont oilsands leases. It accordingly ordered the shutting-in of Wabiskaw-McMurray gas production effective 1 May 2000, for 146 of the 183 wells that were requested to be shut-in.[78]

In response to the decision, the Lieutenant Governor in Council issued an Order in Council[79] pursuant to s. 91 of the *Oil and Gas Conservation Act*.[80] Section 91 enables the

---

75 (1987), 80 A.R. 254 at 258 (C.A).

76 *Supra* note 72 at para. 54.

77 (2001), 285 A.R. 307, [2001] A.J. No. 387 (Q.B.) (QL).

78 *Gulf Canada Resources Limited Request for the Shut-In of Associated Gas, Surmont Area* (March 2000), AEUB Decision 2000-22, online: AEUB <http://eub.gov.ab.ca/BBS/decisions/energy decisions/2000/2000-22.htm>.

79 O.I.C. 196/2000 [OIC].

80 R.S.A. 1980, c. O-5 [*OGCA*].

Lieutenant Governor in Council to direct the AEUB to develop a mechanism for providing compensation to parties who suffer a loss by reason of its orders. Through the OIC, the Lieutenant Governor directed the AEUB to:

> prepare a scheme or schemes for the provision of compensation for persons, *not including the Crown*, having an interest in the petroleum and natural gas rights affected by Decision 2000-22 and who are injured or suffer a loss as a result of the Decision, by those persons, not including the Crown, the AEUB determines should pay such compensation.[81]

Gulf Canada Resources Limited and Petro-Canada Oil and Gas initiated this action for the purpose of seeking a declaration that the OIC was *ultra vires* s. 91, now s. 99,[82] and of no force or effect. The action was initiated on the basis that the OIC purported to direct the AEUB to exclude the Crown as either a recipient or a provider of compensation in any scheme prepared by the AEUB.

The Court of Queen's Bench granted the applicants' request and declared the OIC to be of no force or effect. Justice McMahon noted that the authority of the Lieutenant Governor in Council and the AEUB provided under s. 91 must be distinguished, stating that:

> There are then two distinct roles contemplated by s. 91 for each of the [AEUB] and the Lieutenant Governor in Council to establish a compensation scheme. The role of the Lieutenant Governor in Council is to trigger the process via a direction to the [AEUB] and to make the ultimate decision with respect to whether the scheme should be established. All matters relating to the substance of the scheme are, on an ordinary meaning construction of s. 91, within the purview of the Board. The Board conducts the public hearing and prepares the scheme.[83]

The Court concluded that the construction of s. 91 does not support the ability of the Lieutenant Governor in Council to predetermine significant substantive aspects of a compensation scheme in its direction to the AEUB. Section 91 provides the AEUB with exclusive responsibility for preparing the scheme, thereby precluding the Lieutenant Governor in Council from imposing conditions. Since the Lieutenant Governor in Council's directive to the AEUB expressly attempted to exclude the Crown from the compensation scheme, the OIC was declared *ultra vires* s. 91 of the *OGCA*.

B. *ELIZABETH METIS SETTLEMENT V. METIS SETTLEMENTS GENERAL COUNCIL*[84]

This case addresses promissory estoppel in the context of assigning negotiation rights for resource agreements, and *ultra vires* authority in the context of assigning revenues from subsurface agreements.

---

81 *Supra* note 77 at para. 11 [emphasis added].
82 R.S.A. 2000, c. O-6 [*OGCA*].
83 *Supra* note 77 at para. 28.
84 (2001), 284 A.R. 40, 2001 ABQB 201.

In 1989, the Province of Alberta and the Federation of Metis Settlements Association of Alberta entered into an accord, which was enacted as the *Metis Settlements Act*.[85] The *Metis Settlements Act* was accompanied by the *Metis Settlements Land Protection Act*.[86] Under the *Metis Settlements Act*, eight Metis Settlements were established as corporations. In addition, the Metis Settlement General Council (General Council) was created and established as a corporation. Since the enactment of the *Metis Settlements Act*, the General Council and the eight Metis Settlements had responded to public offerings and negotiated and administered development agreements relating to exploration and development of oil and gas on Metis lands. They were also receiving royalties from productive lands.

By 1996, the General Council and all eight Metis Settlements had decided that the Metis Settlements' collective interests in oil and gas development would be handled by a business corporation, Resco Oil & Gas Ltd. (Resco), owned equally by all Metis Settlements except the General Council. In September 1996, by unanimous resolution, the General Council rescinded previous resolutions about collective action on the oil and gas development and adopted a Mineral Projects Policy (MPP). In November 1996, again by unanimous resolution, the General Council expanded on the MPP by adopting the MPP United Action Guidelines, which stated that the General Council may assign its rights and obligations under a master development agreement to Resco. At the same time, by unanimous resolution, the General Council adopted the Resco business plan, as well as a plan to transfer miscellaneous rights and responsibilities to Resco. Finally, on 9 September 1997, the General Council entered into an Assignment Agreement with Resco, which was to be effective as of 1 April 1997. Under the Assignment Agreement the General Council assigned its negotiating and management rights and obligations to Resco and paid it money from the development of sub-surface resources that would otherwise have been payable to the General Council.

The applicants, the Elizabeth and Peavine Metis Settlements, objected to the assignment of responsibility to Resco and launched the action. They argued that the actions of the General Council were *ultra vires* its authority under the legislation, and sought a declaration that the assignment was void.

The *Metis Settlements Act* contains a Co-Management Agreement in its schedule pertaining to the assignment between Resco and the General Council. Sections 1 and 4 of the Co-Management Agreement provide that the *Metis Settlements Act* contained provisions for dealing with co-management of explorations and development of minerals, and for issuing resource agreements with respect to the minerals; the procedure for issuing resource agreements was set forth in the Co-Management Agreement. Section 702 of the Co-Management Agreement provided that the Co-Management Agreement was not assignable.

Although the Co-Management Agreement expressly prohibited assignment, there was no provision in the *Metis Settlements Act* that precluded the assignment of negotiation rights. Justice Sulyma therefore examined the Co-Management Agreement and the extent of the rights and obligations assigned by the General Council.

---

85 R.S.A. 2000, c. M-14.
86 R.S.A. 2000, c. M-16.

Under the Co-Management Agreement, the General Council was given the authority to receive royalties and address public offerings, as well as to negotiate and administer development agreements. The Court found that each of these rights and responsibilities had been assigned under the Assignment Agreement, such that few of the powers granted under the Co-Management Agreement remained with the General Council. Since the General Council had assigned most of its rights and obligations, the Court found that s. 702 of the Co-Management Agreement had been breached.

The Court noted, however, that the applicants agreed to all of the resolutions proposed throughout 1996 and 1997, which eventually established the Assignment Agreement. Since that time they had fully participated in the internal operations of Resco during the execution of agreements with third-party oil companies. The General Council argued that the past conduct of the applicants gave rise to promissory estoppel, which precluded them from attacking the Assignment Agreement.

The Court cited *Canadian Superior Oil Ltd. v. Paddon-Hughes Development Company*[87] and *Conwest Exploration Co. v. Letain*,[88] noting that promissory estoppel arises in the context of an existing contractual relationship between the parties:

> Where one party makes an unambiguous representation to another party within that existing contractual relationship, which relationship is intended to be acted upon and which is in fact acted upon to the detriment [of that party,] the party making the representation is estopped from enforcing any original contractual obligations.[89]

The Court held that since the applicants, who participated in passing the resolutions approving the assignment to Resco, knew of the existence of the Assignment Agreement for several years and derived benefits under it, they were precluded from attacking it. The respondent's reliance to its detriment was established not only by its execution of the Assignment Agreement, but also by the subsequent endorsement of numerous development agreements. The Court held that, as a result of the applicants' acquiescence, they were estopped from enforcing the respondent's original contractual obligations.

However, the Court agreed with the applicants' argument that some of the provisions of the Assignment Agreement were *ultra vires*, holding that the provisions allowing revenue from subsurface agreements to be paid directly to Resco were *ultra vires* the provisions of the *Metis Settlements Act*. Justice Sulyma therefore concluded that the assignment payments by the General Council to Resco were void and *ultra vires*, and declaratory relief was ordered to the extent that the General Council authorized such payment and use of funds.

87 [1970] S.C.R. 932.
88 [1964] S.C.R. 20.
89 *Supra* note 84 at para. 64.

C. *ATHABASCA CHIPEWYAN FIRST NATION V. BRITISH COLUMBIA HYDRO & POWER AUTHORITY*[90]

This case indicates that an administrative tribunal's decision can be overturned where it is not supported by information that the tribunal was required to consider.

In July 1998, British Columbia Hydro & Power Authority (B.C. Hydro) made application to the National Energy Board (NEB) to obtain electricity export permits. Notice of the application was published, and the Athabasca Chipewyan First Nation (ACFN) intervened on the basis that the issuance of the permits would result in adverse environmental effects.

After considering the evidence of B.C. Hydro and the submissions of the ACFN, the NEB issued the export permits. The NEB found that there would be no significant adverse environmental effects. The ACFN appealed the decision on the basis that the NEB had failed to consider the information before it.

The Federal Court of Appeal reviewed B.C. Hydro's application and attempted to understand what, if any, information was disclosed to the NEB regarding the potential adverse environmental effects that would result from changes to operations or facilities following the issuance of the permits. However, no such information had been disclosed. The Court found that B.C. Hydro's submissions were "obscure." The Court concluded that B.C. Hydro's submission did not address whether the permits would require a change to the operations of existing generating facilities, but only emphasized the environmental benefits of the project instead of addressing potential adverse affects. The Court stated that:

> As worthy as these environmental benefits are, the Regulations require B.C. Hydro to tell the Board about adverse environmental effects. Environmental benefits may be relevant to weigh against adverse environmental effects. However, adverse environmental effects cannot be ignored. Even if there are no adverse environmental effects, some explanation as to why that will be the case would seem to be necessary.[91]

The Court concluded that the NEB's decision was not reasonable given the inadequacy of the information on which it was based. The NEB had failed to consider what operational changes, if any, to existing facilities would occur as a result of the issuance of the permits. It was not open to the NEB to infer from B.C. Hydro's silence that there would not be changes in its operations, following the issuance of permits, that would cause significant adverse environmental effects. As a result, the appeal was allowed, and the NEB's decision to issue the permits was quashed.

---

90 [2001] 3 F.C. 412, 2001 FCA 62.

91 *Ibid.* at para. 19.

D. *GIANT GROSMONT PETROLEUMS LTD. V. GULF CANADA RESOURCES LTD.*[92]

This case discusses the authority of the Alberta Energy and Utilities Board (AEUB) to enact regulations pursuant to the prevention of waste and conservation provisions of the *Oil and Gas Conservation Act*[93] and the *Oil Sands Conservation Act*.[94] The AEUB enacted Regulations 47/99 and 48/99 (the Regulations), which created a mandatory approval process for gas production. The approval process was to apply only where the AEUB found that associated gas production was interfering with the extraction of bitumen in the oil sands using steam assisted gravity drainage (SAGD) technology.[95]

In 1983, the legislature repealed ss. 26(1)(f) and 29(2) of the *OGCA*, which authorized the AEUB to regulate the production of gas occurring within or immediately joining oil sands deposits. In March 1998, after an application by Gulf Canada Resources Ltd. (Gulf) to suspend drilling and production of oil sands leases in the Surmont area, the AEUB directed a general inquiry into the issue of resource conflict in the area. The AEUB subsequently issued a report which accepted that associated gas production would have a significant detrimental effect on SAGD performance.

In February 1999, the AEUB passed the Regulations. The effect of the Regulations was to provide the AEUB with authority to preclude operators from producing gas from wells completed in oil sands areas after 1 July 1998, unless the AEUB approved such production or exempted such wells from the operation of the Regulations. The Regulations also granted the AEUB the power to make any order or direction it considered necessary where gas production may affect recovery of crude bitumen from the oil sands areas.

In April 1999, the AEUB commenced hearing Gulf's application for immediate shut-in of gas production in the Surmont area. In April 2000, the AEUB concluded that continued production presented a significant risk to future bitumen recovery in the area, and ordered the shutting-in of 146 of 183 wells that Gulf requested be shut in.[96]

In May 2000, Cabinet, by an Order in Council,[97] directed the AEUB to prepare a scheme to provide compensation to the producers who had suffered loss due to its decision to shut-in wells. Conventional producers also brought an application for a declaration that the AEUB did not have the authority to enact regulations with respect to an approval process for the production of gas in oil sands. The application was dismissed. The Chambers Judge found that the waste and conservation provisions under s. 21 of the *OSCA* and s. 10 of the *OGCA* expressly empowered the AEUB to pass regulations for these purposes.

---

92 [2001] 10 W.W.R. 99, 2001 CarswellAlta 1058 (C.A.); leave to appeal to S.C.C. refused [2001] S.C.C.A. No. 484 (QL).

93 *OGCA*, *supra* note 80.

94 S.A. 1983, c. O-5.5 [*OSCA*].

95 The depletion of the gas cap from gas production could have the effect of sterilizing bitumen extraction under SAGD.

96 *Supra* note 78.

97 *Supra* note 79.

The gas producers appealed on the basis that the Regulations had not been passed pursuant to legislative authority. In addition, they argued that the interpretive principle of *expressio unius* should apply, given the similarity between the Regulations and the *OGCA* provisions repealed in 1983.

Justice Picard, writing for the majority, conceded that it is a fundamental principle of public law that all governmental action be supported by a grant of legal authority. Justice Picard agreed with the appellants' submission that there was no enabling legislation which expressly granted the AEUB authority to enact regulations to control concurrent production of natural gas and crude bitumen. However, Picard J.A. emphasized that the powers of an administrative tribunal may be implied from the wording of the enabling legislation. Justice Picard stated that in examining the purposes and objectives of the AUEB's enabling legislation, the immediate context and the whole act in which a particular provision appears must be considered, along with any other legislation that may cast light on the words.

Justice Picard examined s. 21 of the *OSCA* and ss. 10(1)(g.02), (l) and (y) of the *OGCA*. Section 10(1)(g.02) of the *OGCA* provides that, *inter alia*, the AUEB may make regulations "respecting the suspension and abandonment of wells," providing for the capping of or otherwise closing in of wells for the purpose of preventing waste, and preventing waste or the improvident disposition of oil or gas. Section 21 of the *OSCA* provides that the AEUB may make regulations respecting "methods of operation to be observed for the prevention of waste" and preventing the "waste or improvident disposition of oil sands, crude bitumen, derivatives of crude bitumen, declared oil sands or oil sands products."

Justice Picard concluded that the AEUB had the authority to pass the Regulations, noting that the AEUB's powers are broad and that the legislature has given it extensive powers to make orders necessary to protect all energy resources. Justice Picard upheld the decision of the Chambers Judge, which held that prevention of waste and conservation of resources were at the root of the AEUB's purpose and existence. As a result, she concluded that the AEUB had been given the exclusive jurisdiction to address energy conservation issues generally, including waste prevention. In further support of her conclusion, Picard J.A. observed that, because energy resources do not occur in isolation, the AEUB must balance competing interests while ensuring the conservation or energy resources and the preservation of the ability to produce concurrent resources. Therefore, the Regulations were consistent with the need to balance the competing interests of gas and bitumen production and to conserve bitumen resources.

With respect to whether the principle of *expressio unius* should apply to the Regulations, Picard J.A. acknowledged the similarity between the Regulations and the repealed provisions. However, she rejected the argument and refused to apply the *expressio unius* principle on the basis that the AEUB retained the authority to enact gas production regulations under other sections of the *OGCA*. As a result, the Regulations were *intra vires* the AEUB.

In dissent, Conrad J.A. held that the repeal of the *OGCA* provisions necessarily precluded the AEUB from creating regulations that require approval for gas production in the oil sands area. She also concluded that the AEUB did not derive sufficient residual authority from the general provisions of the legislation to enable it to make regulations that prefer or protect one resource to the detriment of another. This was a major policy decision that required the

AEUB to have unambiguous authority to make relevant regulations. Although the legislature does not have to list every kind of action that the AEUB may take to fufill its mandate, the legislature must issue clear directives. Justice Conrad stated that the legislative objectives of conservation and waste prevention do not provide the AEUB with the authority to enact regulations limiting associated gas production, and the Regulations were therefore *ultra vires* the AEUB.

The respondent urged the Court to consider that the repeal of the *OGCA* provisions took place at a time when SAGD technology did not exist, and when resource conflict in the oil sands was thus virtually non-existent. However, Conrad. J.A. interpreted the inaction of the legislature as an indication that it did not intend to provide the AEUB with the authority to regulate associated gas production where resource conflicts exist.

E. *METIS NATION OF ALBERTA ZONE II REGIONAL COUNCIL V. ALBERTA (DEPARTMENT OF ENVIRONMENTAL PROTECTION)*[98]

This case deals with s. 84 of the *Environmental Protection and Enhancement Act*,[99] which allows parties directly affected by the Director's decision to appeal. AEC Pipelines Ltd. (AEC) sought to obtain approval under the *EPEA* to initiate a pipeline project near Cold Lake. On 8 August 2000, the Metis Nation of Alberta Zone II Regional Council (the appellants) wrote to the Director to file a Statement of Concern in relation to the project. The letter advised the Director that the appellants were stakeholders, that they utilized the resources in the region and that increased activity had deteriorated hunting and trapping productivity.

On 30 August 2000, the Director wrote to the appellants, advising them that Alberta Environment required further information to determine whether any of the Metis Nation members were directly affected by the project. The letter warned that if a response was not received by 8 September 2000, the submission would not be considered an official Statement of Concern under s. 84 of the *EPEA*.

The 8 September 2000 deadline passed with no reply. On 13 October 2000, the appellants wrote to the Director in order to provide the additional information the Director had requested. Specifically, the appellants stated that the project area was utilized for harvesting traditional medicinal herbs and trapping, and that both activities would be adversely affected by the change in the wildlife habitat created by the project. A number of statements from Metis Elders were attached to the letter. The letter also alleged that AEC had failed to consult with them regarding the project.

On 15 November 2000, the Director informed the appellants that they had not provided any indication of current land use by the Metis. The letter also advised that the 13 October 2000 letter was not a formal Statement of Concern for the *EPEA* review of the project. On 16 November 2000, the Director issued Approval No. 136570-00-00 to AEC for the project.

---

98 (2001), 38 C.E.L.R. (N.S.) 14 (A.E.A.B.), [2001] A.E.A.B.D. No. 14 (QL).

99 R.S.A. 2000, c. E-12 [*EPEA*].

The appellants filed two notices of appeal pursuant to s. 84 of the *EPEA*. The Director brought this application to dismiss the notices of appeal filed by the appellants.

The main issue before the Alberta Environmental Appeal Board (AEAB) was whether the appellants were "directly affected" by the pipeline approval. Section 84(1)(a)(iv) of the *EPEA* provides that a notice of appeal may be submitted to the AEAB where the Director issues an approval, by any person who is directly affected by the Director's decision. The appellants argued that they were directly affected by the project because they used and relied on the natural resources and watercourses in the project's immediate proximity.

The first task of the AEAB was to determine the issue of standing. The AEAB referred to its decision in *Wessley v. Alberta (Department of Environmental Protection)*,[100] which held that standing must be determined on a case-by-case basis, taking into account the particular facts and circumstances of each appeal. The AEAB also cited the test in *Kostuch v. Alberta (Department of Environmental Protection)*,[101] which requires the party seeking standing to demonstrate a personal interest that is directly impacted by the approval granted. There must be a demonstrable causal connection between the approval and the effect on the party's interest. As the causal connection between an approval and the effect becomes more remote, the capacity for standing diminishes.

In order to obtain standing, the party must prove that they are "directly affected" by an approval; that is, that the alleged harm to the interest was caused by the approval. As a general rule, there must be an unbroken connection between the harm and the approval. In addition, the party claiming to be affected must demonstrate that its interest is more than the abstract interest of all Albertans — that it has a personal interest. Even in a case where a group advances the interest, the group will still have to prove that some of its members have their own standing.

In *Bailey v. Alberta (Department of Environmental Protection)*,[102] the AEAB recommended that individual members of the organization file appeals (in addition to the group filing). The AEUB held that, in order to demonstrate the personal impact required by s. 84 of the *EPEA*, the group was required to show that the majority of individual members of the organization were individually and personally impacted by the project.

After considering the evidence, the AEAB dismissed the appeal on the basis that the appellants were not a directly affected group. No specific individual had been included or identified in the appeal with sufficient evidence to conclude that they were directly affected. In addition, the majority of the group members were not impacted by the project. Since the *EPEA* requires the AEAB to seek an appropriate balance between a broad range of environmental and economic interests, the appeal was dismissed and the project approvals were confirmed.

100 [1994] A.E.A.B.D. No. 2 (QL).
101 (1995), 17 C.E.L.R. (N.S.) 246, [1995] A.E.A.B.D. No. 9 (QL).
102 [2001] A.E.A.B.D. No. 10 (QL).

F. *PLATEAU PIPE LINE LTD. V. BRITISH COLUMBIA (UTILITIES COMMISSION)*[103]

This case addresses the methods used by the British Columbia Utilities Commission (BCUC) to set pipeline tolls, and is the first comprehensive review of oil pipeline tolls that the BCUC has undertaken under the *Pipeline Act.*[104] Prior to this decision, the *Pipeline Act* had never been judicially considered in any significant way.

An order by the BCUC set the permanent tolls that Plateau Pipe Line Ltd. (Plateau) and Pembina Pipeline Corporation (Pembina) could charge shippers for the transportation of crude oil through their pipeline. Plateau appealed the order pursuant to s. 101 of the *Utilities Commission Act.*[105]

Section 45 of the *Pipeline Act* requires all tolls to be just and reasonable. However, this had never been judicially considered. The appellants argued that the BCUC had erred by: (1) failing to provide fair compensation for owning and operating a pipeline; (2) confiscating the value of the pipeline that existed at the time of the hearing; (3) disregarding the competitiveness of the toll compared to other pipelines; (4) failing to address the issue of vanishing rate base; and (5) requiring Plateau to invest substantial capital into the pipeline without considering the economic reasonableness of the investment.

In addition, the appellants claimed that the BCUC had exceeded its jurisdiction by: (a) making findings regarding safety and technical matters which were in the exclusive jurisdiction of the Oil and Gas Commission (OGC); (b) requiring the toll application to proceed while safety issues were being addressed by the OGC; (c) failing to consider statutory obligations to operate the pipeline in an environmentally safe manner; and (d) treating Plateau's parent company as a common carrier under the *Pipeline Act.*

In rendering its decision, the Court of Appeal (Thackray J.A. in Chambers) cited *Trans Mountain Pipe Line Company Ltd. v. Canada (National Energy Board),*[106] which considered tolls set under the *National Energy Board Act.*[107] In that case, the Court stated that:

> Whether or not tolls are just and reasonable is clearly a question of opinion which, under the Act, must be answered by the Board and not by the Court.... If ... the Board addresses its mind to the right question, namely, the justness and reasonableness of the tolls, and does not base its decision on clearly irrelevant considerations, it does not commit an error of law merely because it assesses the justness and reasonableness of the tolls in a manner different from that which the court would have adopted.[108]

Based on the decision in *Trans Mountain,* the Court concluded that the BCUC must not base its decision on clearly irrelevant considerations. However, the BCUC has discretion, which, if used properly, is unfettered in the sense of statutory constraints or requirements. The Court agreed with the BCUC's submissions that where there is a general power to set

---

103 2002 BCCA 149.
104 R.S.B.C. 1996, c. 364.
105 R.S.B.C. 1996, c. 473.
106 [1979] 2 F.C. 118 (C.A.) [*Trans Mountain*].
107 R.S.C. 1985, c. N-7.
108 *Supra* note 106 at para. 121.

just and reasonable tolls without specified statutory criteria, the determination of that question is a matter of fact and not of law or jurisdiction. The Court also agreed with the BCUC's submission that the applicants were seeking to have the Court substitute its opinion on what constitutes a "just and reasonable" toll. The Court acknowledged that the BCUC had heard the arguments put forward by the applicants on two prior occasions and had not found them persuasive. As a result, the Court held that the method applied by the BCUC met the test under s. 45 of the *Pipeline Act*. The application for leave to appeal was dismissed.

The Court also examined the issue of whether Pembina was a common carrier. The Court concluded that it was, because Pembina: (1) held itself out as an owner and operator of a pipeline and as a common carrier; (2) held itself out to the community at large through its prospectus as an operator; and (3) recognized that the system was subject to common carrier obligations.

Justice Thackray's decision in Chambers was upheld by the British Columbia Court of Appeal.[109]

G. *ATCO ELECTRIC LTD. V. ALBERTA (ENERGY & UTILITIES BOARD)*[110]

This was an application by ATCO Electric Ltd. (ATCO) for leave to appeal a decision of the Alberta Energy & Utilities Board (AEUB). In its original decision, the AEUB rejected ATCO's request to have a \$4.6 million management fee rolled into its Regulated Rate Option Tariff (RROT). The management fee represented the non-energy component of the RROT and was requested by ATCO to compensate for providing the Regulated Rate Option (RRO) service.

In rejecting the management fee, the AEUB noted that the regulations did not set out the principles that must be used to evaluate the non-energy components of the RROT. The AEUB determined that: (1) "ATCO had not persuaded it that there was significant value added for the customers"; (2) "there was no indication that the parties to the settlement considered it to include a value added portion"; and (3) "the provision of the RROT was more onerous than other rate options."[111]

On 8 March 2001, ATCO applied for a review of the AEUB's decision pursuant to s. 64 of the *Public Utilities Board Act*[112] and s. 57 of the *Electric Utilities Act*.[113] The AEUB denied the review on the basis that it had not erred in fact or in law.

ATCO then launched this action on the basis that the AEUB had erred in its jurisdiction by making a decision that was patently unreasonable given the evidence before it. ATCO alleged that the AEUB had erred in fact by determining that there was no evidence that the settlement contained a provision for value-added service that could justify the management fee. ATCO also argued that the AEUB had erred in law on the basis that its failure to

[109] 2002 BCCA 246, 2002.
[110] (2002), 299 A.R. 337, 2002 ABCA 45.
[111] *Ibid.* at para. 4.
[112] R.S.A. 2000, c. P-45.
[113] R.S.A. 2000, c. E-5.

recognize the increased costs and risks of the RRO services was patently unreasonable and did not recognize ATCO's legal right to be compensated for providing the RRO service.

In addressing the issue of leave to appeal, Paperny J.A. utilized the test set out in *ConCerv v. Alberta (Energy & Utilities Board)*, which stated that "The relevant inquiry is whether, having regard to the standard of review, the issues engaged raise serious arguable points of law."[114] There are four applicable elements in the general test:

(1) whether the point on appeal is of significance to the practice;
(2) whether the point raised is of significance to the action itself;
(3) whether the appeal is *prima facie* meritorious or, on the other hand, whether it is frivolous; and
(4) whether the appeal will unduly hinder the progress of the action.[115]

According to Paperny J.A., "A fifth consideration is the standard of appellate review which would be applied if leave were granted."[116]

Justice Paperny also followed the reasoning set forth in *Bell Canada v. Canada (Canadian Radio-Television & Telecommunications Commission)*,[117] and stated that:

> Decisions of the AEUB, made within its jurisdiction, or interpreting its constituent statutes and regulations, and involving the application of its experience and expertise, will be accorded a measure of deference even where there is a statutory right of appeal ... The standard applicable to appeals of the decisions of the AEUB based on an allegation of error of law is one of reasonableness.[118]

Justice Paperny granted leave to appeal. She was persuaded that the statutory provisions require the AEUB: (1) to establish frameworks and rules for promoting the purposes of the *Act*; (2) to have regard for the reasonable opportunity to recover costs; and (3) to determine a just and reasonable rate base, including a fair return. Thus, although the application for leave to appeal on the basis of jurisdiction was refused, leave to appeal the question of an error of law was granted. Justice Paperny stated that the issue on appeal was as follows:

> Was the AEUB's refusal to review and vary its decision on the RROT an error in law in light of the circumstances and its statutory mandate including s. 52 of the *Electric Utilities Act*, R.S.A. 2000, c. E-5, and s. 90 of the *Public Utilities Act*, R.S.A. 2000, c. P-45, to provide reasonable compensation for the services provided?[119]

---

114 2001 ABCA 217 at para. 4.
115 *Power Consolidated (China) Pulp Inc. v. British Columbia Resources Investment Corp.* (1988), 19 C.P.C. (3d) 396 at 397 (B.C.C.A.).
116 *Supra* note 110 at para. 14.
117 [1989] 1 S.C.R. 1722.
118 *Supra* note 110 at para. 20.
119 *Ibid.* at para. 32.

IV. FREEHOLD LEASES

A. *TAYLOR V. SCURRY-RAINBOW OIL (SASK.) LTD.*[120]

Alicia Quesnel deals with this case in some detail in her article, "Modernizing the Property Laws that Bind Us," published in this issue.[121]

B. *MONTREAL TRUST CO. V. WILLISTON WILDCATTERS CORP.*[122]

In this case, a lessee unsuccessfully challenged the termination of an oil and gas lease. The lease was a 1952 freehold gas lease containing a primary term of ten years, with the *habendum* clause providing that:

> TO HAVE AND ENJOY the same for the term of Ten (10) years ... so long thereafter as the leased substances or any of them are produced from the said lands ...
>
> ...
>
> AND FURTHER PROVIDED that if at any time after the expiration of the said Ten (10) year term the leased substances are not being produced on the said lands and the Lessee is then engaged in drilling or working operations thereon, this lease shall remain in force so long as such operations are prosecuted ... and provided that if drilling, working or production operations are interrupted or suspended as the result of any cause whatsoever beyond the Lessee's control, the time of such interruption or suspension shall not be counted against the Lessee.[123]

The lease was continued by actual production until January 1990, at which time the initial lease continuation well (the Initial Well) was shut in. Production started again from the Initial Well in August 1990. However, in May 1991, the Initial Well was permanently shut in. The plaintiff sought a declaration that the contract terminated as a result of non-production, thereby disentitling the defendant to a share in the production. The issues were whether the lease had terminated and, if it had, whether the plaintiff was estopped from obtaining any relief.

The plaintiff argued that production had ceased for a period of time between August 1990 and May 1991, during which time the lessee had not engaged in any "drilling or working operations" as required under the *habendum* clause. The Court examined the definition of "working operations" as provided in *Canadian Superior Oil Ltd. v. Crozet Exploration Ltd.*[124] In response to the question of whether the time for actually drilling a well could be extended by preparatory work, the Court stated that:

> I do not think that all preparatory work ... would be sufficient to extend the lease beyond the critical date. Not only must the actions undertaken before the critical date be preparatory ... but, in my view the actions so taken must also be subjected to the following additional tests:

---

120 (2001), 203 D.L.R. (4th) 38 (Sask. C.A.).

121 *Supra* note 58.

122 2001 SKQB 360, aff'd 2002 SKCA 91.

123 *Ibid.* (Q.B.) at para. 4.

124 (1982), 133 D.L.R. (3d) 53 (Alta. Q.B.) [*Canadian Superior Oil*].

1) The preparatory steps or actions must be taken in good faith with the intention of completing the drilling of an oil and/or gas well.
2) The preparatory steps or actions must be taken with reasonable diligence and dispatch tested by the principles of good oil field practice.
3) The preparatory steps or actions must not simply be minimal.[125]

Based on the principles expressed in *Canadian Superior Oil*, Gerein C.J. determined in the present case that "working operations," as contemplated by the *habendum* clause, must be activities which are directed to bringing about the production of oil. The Court then considered the activities undertaken by the defendant to determine whether they fell within the definition of "working operations," including: (a) the installation of an above ground storage tank; (b) snow removal and hauling of salt water from the pit; (c) building a fence and digging a dugout; (d) work done on a service rig; and (e) payment of taxes, maintaining the surface lease and filing reports and correspondence.

The Court held that the operations conducted by the defendant did not constitute "working operations." Since the storage tank was installed in 1989 prior to the halting of production in January 1990, the Court did not view its installation as part of the working operations in 1990. Removing snow, hauling salt water, building the fence and digging the dugout were not related to the production of oil. Work performed on the service rig did not constitute "working operations" because it was performed as part of the company's overall business operation. In addition, the payment of taxes, maintaining the surface lease, filing reports and correspondence were simply administrative matters.

The Court did determine that thawing the flow line in January and March of 1990 constituted "working operations." Each attempt was undertaken to bring about production. However, the Court concluded that these were isolated acts, widely spaced in time and pursued only briefly. As a result, they were not sufficient to extend the lease.

The defendant argued that extremely cold weather, causing the freezing of the flow line and the imposition of road bans from 18 March to 29 April 1990, prevented it from getting the Initial Well back into production. The Court rejected these arguments and held that, since the defendant did not take any action to ensure continuous production, the flow line freezing and the road bans were not causes beyond its control. The Court therefore found that the lease terminated on 3 January 1990, and could not be saved by the *habendum* clause.

The defendant argued in the alternative that the lease should be continued by reason of estoppel as the plaintiff made representations indicating that the lease was valid at all relevant times. Those representations included the continued acceptance of royalty payments in early 1990, following the permanent shutting-in of the well, and consent to the defendant's proposal to drill a horizontal well. The defendant argued that the continued payments should now prevent the plaintiff from denying that there was a right to drill the "11-8" well, and that the defendant was entitled to share in the production realized from that well.

---

[125] *Ibid.* at para. 62.

The Court considered the essential elements for estoppel by representation in *Wauchope v. Maida*, and summarized them as follows:

> "1) a representation of an existing fact or a promise about the future; 2) an intention, or a reasonable presumption of an intention, that the representation be acted upon; 3) reliance upon the representation; and 4) alteration of the representer's position to that party's detriment. The burden of proof rests with the party alleging estoppel."[126]

Chief Justice Gerein found that the actions of the plaintiff did not amount to a representation of fact, nor did they manifest an intention that a representation be acted upon. The acceptance of the royalty cheques and the consent to drill the well were passive courses of conduct. The plaintiff did not know that the lease had terminated and was under a mistaken belief that the lease was valid, thereby providing no reason to conclude that it was at any time making any representation about the validity of the lease. Since mutual mistake does not give rise to estoppel, the Court concluded that the defendant's argument must fail.

In the alternative, the defendants argued that the plaintiff should be estopped from asserting that the lease terminated on the basis that it failed to assert the termination and its right to re-enter before the drilling of the new 11-8 well. Chief Justice Gerein reviewed the essential elements of estoppel by acquiescence set forth in *Willmott v. Barber*[127] and approved in *Canadian Superior Oil Ltd. v. Paddon-Hughes Development Co. and Hambly*:[128] 1) the defendant must have made a mistake as to its legal rights; 2) the defendant must have expended some money or performed some act on the basis of the mistaken belief; 3) the plaintiff must know of the existence of its own right, which is inconsistent with that right claimed by the defendant; 4) the plaintiff must know of the defendant's mistaken belief about its rights; and 5) the plaintiff must have encouraged the defendant in its expenditure of money or other acts, either directly or by abstaining from asserting its legal right.

The Court concluded that both parties were operating under the mistaken belief that the lease was still valid. As a result, there was no reason to hold that the lack of production or cessation of royalty payments cast an obligation on the plaintiff to conclude that there was no drilling or working operations on the lease. Since both parties were under a mistaken belief, the knowledge required to give rise to estoppel was absent, and estoppel by acquiescence had no application.

The defendant also advanced the argument of proprietary estoppel. According to *Stiles v. Tod Mountain Development Ltd.*,[129] proprietary estoppel may be granted where a party expends money on the land of another under an expectation created or encouraged by the owner, or even where the landowner merely stands silent. Whenever proprietary estoppel has been granted, there has been an underlying legal relationship between the parties, or at least some form of an understanding. Since neither was present in this case, and it could not be said that the plaintiff requested or encouraged the defendant to act as it had, the Court rejected the defence of proprietary estoppel.

---

126 (1971), 22 D.L.R. (3d) 142 at para. 68 (Ont. C.A.).
127 (1880), 15 Ch.D. 96 at 105; aff'd 17 Ch. D. 722 (C.A.).
128 [1970] S.C.R. 932 at 938.
129 (1992), 88 D.L.R. (4th) 735 at 743 (B.C.S.C.).

Finally, the defendant argued that the requirement of notice provision in the lease prevented the termination of the contract. That provision stated as follows: "In case of a breach, non-observance or non-performance on the part of the Lessee of any covenant, proviso, condition, restriction or stipulation ... the Lessor may give to the Lessee written notice requiring him to remedy such default."[130] Chief Justice Gerein determined that the provision was permissive and not mandatory and, as a result, the plaintiff was not required to provide notice to the defendant as a precondition to termination. Therefore, the 1952 lease had been validly terminated.

The Court of Appeal upheld Gerein C.J.'s decision and dismissed the appeal.[131]

V. LAND TITLES

A. *STRANGE V. BINQ INDUSTRIES INC.*[132]

This case addresses unregistered interests under the *Land Titles Act*.[133] A landowner granted a twenty-five-year surface lease to Petcal Company Ltd. (Petcal), which registered a caveat against the surface title. The lessee's interest under the lease was ultimately assigned to Penn West Petroleum (Penn West). In 1991, all of the lessor's rights under the surface lease were assigned and transferred to the plaintiff, who did not register a caveat. In 1998, the defendant, Binq Industries (Binq), acquired title to the lands subject only to the Petcal caveat and a utility gas right of way, and maintained entitlement to amounts owing under the surface lease. Penn West then commenced an action seeking direction regarding which party was entitled to the surface lease payments.

Binq submitted that it was entitled to the surface lease payments because the plaintiff did not have a caveat filed on the land when Binq acquired title. Counsel referred to s. 66(1) of the *Land Titles Act*, which provides that:

> Every certificate of title granted under this Act (except in case of fraud wherein the owner has participated or colluded), so long as it remains in force and uncancelled under this Act, is conclusive proof in all courts as against Her Majesty and all persons whomsoever that the person named therein is entitled to the land included in the certificate for the estate or interest therein specified....

Master Quinn concluded that Binq was entitled to receive the income from the surface lease. Since Binq did not know about the plaintiff's claim to the surface lease until after the purchase of the property, no fraud was committed under the *Land Titles Act*. However, the Court stated that even if Binq had known about the unregistered interest before purchasing the property, it would not have been fraudulent under the *Land Titles Act* for Binq to purchase the property and insist that it was entitled to any surface rental. Knowledge of the existence of an unregistered interest shall not by itself be interpreted as fraud within the meaning of the *Land Titles Act*.

---

130 *Supra* note 122 at para. 5.
131 2002 SKCA 91.
132 (2001), 292 A.R. 375, 2001 ABQB 477.
133 R.S.A. 1980, c. L-5.

The Court concluded, therefore, that Binq had priority to the revenue generated from the surface rental. Although the Court determined that the plaintiff had a valid interest in the surface lease, he was not entitled to the lease payments. Priority was lost because a caveat had not been registered to protect the interest against subsequent purchasers.

An interesting issue arises where an interest in land is acquired pursuant to a document such as an oil and gas top lease. The acquired interest is typically taken subject to liabilities, such as existing uncaveated leases. Where an attempt is made to defeat the unregistered interest, actual fraud under the *Land Titles Act* may be found. As a result, the top lessee and its agents should not make representations to the top lessor that the interests are acquired subject to any liabilities or interests previously existing against or encumbering the land in question.

B. *574095 ALBERTA LTD. V. BRENDANCO INVESTMENTS INC.*[134]

This case deals with successive purchasers of interests that are subject to equitable liens and the criteria required for the defence of sheltering.

This case involved a dispute among ten corporations collectively know as the Tencos. Two of the Tencos, Claude Resources Inc. (Claude) and Nucorr Petroleums Ltd. (Nucorr), each made payments to satisfy their proportionate share of operating deficiencies. However, the other eight Tencos failed to make similar payments. Claude and Nucorr claimed an equitable lien against the interests of the eight other Tencos. The equitable lien was never registered and the other Tencos subsequently sold their working interests to other corporations. The issue was whether the equitable lien could be enforced against the subsequent purchasers of the eight Tencos' interests.

Justice Park held that the plaintiff had demonstrated unjust enrichment on the basis of a constructive trust. The plaintiff had been granted an equitable lien on the working assets of the defaulting Tencos since 16 October 1986, which extended to all of the assets covered by the Tencos. Each Tenco had a 10 percent undivided interest in those assets as a whole and the equitable lien attached to the assets as a whole. The Court concluded that the plaintiff was entitled to a charge on the working interests to secure payment of the contributions of Claude and Nucorr. The equitable lien could be enforced to ensure repayment of the monies advanced when there became money allocable to the appropriate account. However, the equitable lien could not become payable until monies became allocable to the account.

Having found attachment of the equitable lien to the whole of the undivided interest of the Tencos' working interests, the Court then addressed the defence of sheltering raised by the defendants. Justice Park noted that:

> The purpose of the doctrine of sheltering is to protect the interests of a bona fide purchaser for value from the registration of charges of which it had no knowledge and which would adversely affect his or her ability to sell such an interest at a price commensurate with the value (i.e. an unencumbered interest) for which it paid for the interest.

---

134 2002 ABQB 277.

...

The doctrine is succinctly stated in "Snell's Equity" 30th Edition by John McGhee at page 60:

> The protection of the doctrine of purchaser without notice extends to any person who claims through such a purchaser, unless that person was himself previously bound by the equity. Thus a purchaser with notice of an equitable interest will nevertheless not be bound by it if he purchases from a person who himself was a purchaser without notice. Here the second purchaser can shelter under the first purchaser, because otherwise a bona fide purchaser might be unable to deal with his property, and the sale of the property would be clogged. But a trustee cannot defeat the equities of his beneficiaries by selling the trust property to an innocent purchaser and then buying it back.[135]

The defendants argued that the failure to register this equitable lien was fatal because equity favours a *bona fide* purchaser for value. If a lien has not been registered, then a *bona fide* purchaser for value without notice obtains title to the interest free and clear of any charge that may or may not have existed. The defendants argued that notice of the equitable lien was not given to any of the intervening purchasers of the Tencos' assets. As such, each of the subsequent intervening purchasers obtained the working interests free and clear of notice of any lien or charge that Claude or Nucorr may have possessed against such working interests.

The Court found that notice had not been provided to any intervening purchasers. However, the Court also noted that no evidence was produced to indicate that "the intervening purchasers did not have other notice of the debt or the circumstances and nature of the debt (that is, the equitable lien) owing to Claude and Nucorr."[136]

The Court determined that a lack of notice from the lien holder does not eliminate knowledge by the intervening purchasers. The intervening purchasers could have received notice from sources other than Claude, Nucorr or the plaintiff. The Court was not able to speculate whether or not the intervening purchasers had notice of the equitable lien of its circumstances and nature from other sources. As such, there was no evidence before the Court that the intervening purchasers were *bona fide* purchasers for value without notice. As a result of this lack of evidence, the Court concluded that the defendants had failed to establish their defence and that, therefore, the doctrine of sheltering did not need to be considered.

The Court then considered the "curtain principle" within the *Land Titles Act*,[137] which prevents a party from asserting an unregistered charge against a person who has acquired the interest in question. The Court found that the defendants were given express notice of the plaintiff's claim the day before closing the purchase. As a result, they did not obtain the same title to the Tencos' assets under s. 66(2) of the *Land Titles Act* as prior intervening purchasers. Therefore, the Court concluded that the defendants obtained title to the interests subject to the lien and other registered caveats of the plaintiff.

---

135 *Ibid.* at paras. 85-86.
136 *Ibid.* at para. 88.
137 *Supra* note 133.

The conclusion in this case raises interesting issues. If in fact it could be established that the intervening purchasers were *bona fide* purchasers for value without notice of the equitable lien, could the new purchasers shelter themselves under the prior purchasers which had no notice of the equitable lien? It is not clear how the position of the new purchasers would be handled under the *Land Titles Act* (which would ordinarily result in title to the interest being subject to the lien). The purpose of the equitable doctrine of sheltering runs counter to the *Land Titles Act.* Should the defendants here have delayed closing and requested that, in the interim, the intervening purchasers take action against the subsequently registered caveats? On what basis would the intervening purchasers take issue with otherwise valid — albeit subsequent — caveats?

VI. SURFACE RIGHTS

A. *CANADIAN OCCIDENTAL PETROLEUM LTD. V. ANTONIUK*[138]

In this case, Canadian Occidental Petroleum Ltd. (Canadian Occidental) appealed a surface compensation award made by the Board of Arbitration (the Board) pursuant to the *Surface Rights Acquisition and Compensation Act.*[139] This case addresses the principles used to determine compensation for the value of land when quantifying an award.

Canadian Occidental appealed, arguing that there was no evidence before the Board to support the award made and that the Board had erred in law in determining the value of the lands. The Board had based the award on the offers made by Canadian Occidental to the respondent landowners in right-of-entry documentation, finding that these offers had been fair and reasonable. However, the offers had been withdrawn prior to the hearing. As a result, Canadian Occidental alleged that there was no evidence before the Board to support its findings.

For the Court of Appeal, Lane J.A. stated as follows:

> The Board clearly stated the basis on which it made the awards of compensation for the value of the lands. It made the awards solely on the basis of the offers made on the applications for immediate right of entry made pursuant to ss. 31 and 33. However, such offers are made, at least in part, to induce landowners to allow the operators onto the land immediately. This urgency of itself is not evidence of an indicator of the value of the land to the owner. Further, the offers were made to compensate the owners for all of the factors set out in s. 29(1). This includes such factors as severance, adverse effect, nuisance, loss of use etc. Thus the offers could not be broken down to reflect solely the "value of the land." The Board clearly misconstrued the evidence pertaining to the offers.
>
> Further, the Board clearly ignored the testimony of ... the landsman, as to the value of the land. His evidence was neither challenged nor contradicted and was the only direct evidence as to value. In my view, the Board clearly committed an error of law by basing its awards solely on an offer which had been withdrawn. It

[138] 2001 SKCA 12.

[139] R.S.S. 1978, c. S-65.

compounded that error by disregarding the only concrete and direct evidence pertaining to the value of the land.[140]

Another issue raised in this case was the basis on which the Board determined the amounts awarded for severance, adverse effect, nuisance, inconvenience, disturbance, noise and loss of use. On this issue, Lane J.A. observed that:

> There certainly was evidence before the Board, (for example: calculations from the Crop Planning Guide prepared by Saskatchewan Agriculture, evidence of earlier leases, evidence of purchase prices, taxable assessments, nearby sales, previous settlements negotiated with other companies, photographs, and affidavits of the respondents), and the Board made a site inspection, thus making these questions of fact or at best questions of mixed law and fact. Indeed the appellant conceded there was some evidence for "loss of use." However, in the interests of consistency and for the reasons set out in *Fletcher Challenge* all of these matters should be remitted to the Board for a redetermination. This will enable the Board to clearly set out the principles on which it bases the awards and indicate the supporting evidence.[141]

Justice Lane concluded by noting that one of the purposes of the legislation is "to provide a quick and inexpensive method of resolving issues between the surface rights holders and the operators."[142] In order to have matters dealt with quickly and expeditiously to the benefit of the operators, it is not necessary for the Board to provide more than a brief but clear explanation of the award.

B. *LEGAL OIL & GAS LTD. V. ALBERTA (SURFACE RIGHTS BOARD)*[143]

This was an appeal from a decision of the Surface Rights Board (the Board) on whether the definition of "operator" under the *Surface Rights Act*[144] was a question of law that could be decided on appeal. The definition of "operator" had not been raised before the Board.

Legal Oil & Gas Ltd. was the licensee of a well drilled under an Alberta Crown Petroleum and Natural Gas Lease that expired in 1985. On expiry of the subsurface rights, ownership of the well vested in the Crown by virtue of s. 32(1) of the *Mines and Minerals Act.*[145] Legal remained the lessee under a surface rights lease (the Lease) granted in respect of the well site and roadway for the well in question. The well had never produced and the site had never been cleaned up. As such, no reclamation certificate was obtained by Legal, which also had not made payments under the Lease from 1994 onwards.

The lessor made an application to the Board for payment pursuant to s. 36(1) of the *Surface Rights Act* which, given its extraordinary provisions, warrants repeating:

---

140 *Supra* note 138 at paras. 9-10.
141 *Ibid.* at para. 11, referring to *Fletcher Challenge Energy Canada Inc. v. Sulz*, [2001] 6 W.W.R. 476, 2001 SKCA 11.
142 *Ibid.* at para. 12.
143 (2001), 303 A.R. 8 (C.A.).
144 R.S.A. 2000, c. S-24, s. 1(h).
145 R.S.A. 2000, c. M-17.

36(1) When an operator fails to pay, within 30 days following the day on which it was due, any money under a compensation order or surface lease, the person entitled to receive the money may submit to the Board evidence of the failure.

(2) When the evidence submitted is satisfactory in the opinion of the Board with respect to the failure to pay, the Board may direct the Provincial Treasurer to pay out of the General Revenue Fund the amount of money to which the person is entitled.

(3) If the Provincial Treasurer pays money to a person under subsection (2), the amount paid thereby constitutes a debt owing by the operator to the Crown.

The Board found that the lessor was entitled to payments. However, Legal had not argued that it was not an "operator" for the purposes of s. 36(1) at the hearing.

Legal then brought an unsuccessful application for judicial review, which decision it appealed. During that hearing Legal raised the issue of whether it was an "operator" for the purposes of s. 36(1) of the *Surface Rights Act*. The Court gave Legal leave to file a supplemental factum dealing with this new issue.

Legal argued that it was not an "operator" because it had no right to the minerals and no right to work the minerals after the termination of the subsurface mineral lease. Legal relied on the definition of "operator" in s. 1(h) of the *Surface Rights Act*, which provides that "operator" means "(i) the person … having the right to a mineral or the right to work it, or the agent of such person or group of persons."

In response to this claim, the Court of Appeal stated that, barring exceptional circumstances, it would not decide questions that had not been raised before the Board. In dismissing the appeal, the Court noted that the Board's members had extensive knowledge of policy, the industry and its requirements, acceptable practices in the industry and the concerns of the landowners. Because the issue required a detailed consideration of law and policy, the Court declared the Board a more appropriate forum and declined to hear the matter.

C. *ATCO ELECTRIC LTD. V. ALBERTA (SURFACE RIGHTS BOARD)*[146]

In this case, the Surface Rights Board (the Board) had been asked to determine compensation in respect of a powerline easement. The landowner gave evidence that he could no longer farm around power poles on his property due to an inability to manoeuvre wider farm machinery. In the past, the landowner had been able to rent smaller machinery to farm in the easement, but the equipment was no longer available. Upon hearing this evidence, ATCO Electric Ltd. (ATCO) tripled its original offer for annual compensation.

The Board accepted ATCO's proposal. However, following this decision, a representative of ATCO observed that the landowner's farming patterns had not changed and that he continued to farm around the power poles. ATCO requested a rehearing based on the new evidence, but the Board refused to reconsider the matter. ATCO then asked the Board to

146 (2001), 301 A.R. 205 (Q.B.).

reconsider its decision or review the compensation, but again the Board refused. ATCO responded by bringing an application for judicial review.

The Court observed that the pragmatic and functional approach outlined in *Pushpanathan v. Canada (Minister of Citizenship and Immigration)*[147] should be applied. Justice Lefsrud noted that the absence of a privative clause in the *Surface Rights Act*[148] and the availability of an appeal process suggested a less deferential standard of review.

The Court noted that the Board's expertise is the most important factor to be considered. The focus should be on the expertise of the Board as compared to the reviewing court. In this case, the Court found that "the Board clearly [had] expertise in setting and varying compensation for surface leases..., [which] expertise would presumably also be relevant to a decision whether new evidence necessitates a rehearing or a review of an order."[149]

Further, Lefsrud J. noted that the purpose of the *Surface Rights Act* was to create a regime for settling disputes, including disputes regarding compensation between landowners and operators who have rights of entry onto the landowner's land. There were no restrictions on the Board's ability to revisit compensation orders. The fact that the legislature had not placed any restrictions on the Board's discretion to review its decision indicated a deferential standard of review.

Finally, the Court noted that s. 32 of the *Surface Rights Act* granted the Board "a very broad discretion to decide when to review its decisions or orders ... [and that] this factor also indicate[d] a deferential standard of review."[150] Weighing these various factors, Lefsrud J. determined that "the appropriate standard of review is the most deferential standard of patent unreasonableness."[151]

However, the Court noted that a "discretionary decision will be found to be patently unreasonable if the discretion was exercised in a manner that was clearly irrational."[152] Justice Lefsrud then concluded that it was irrational for the Board to refuse to review the order once it discovered that the basis on which it had granted the order no longer existed. The Board was directed to reconsider ATCO's request for a review of the compensation decision. The Board could only refuse the request where it provided rational reasons for the refusal, taking into account the basis of its original decision.

---

147 [1998] 1 S.C.R. 982.
148 *Supra* note 144.
149 *Supra* note 146 at para. 21.
150 *Ibid.* at para. 25.
151 *Ibid.* at para. 26.
152 *Ibid.* at para. 27.

VII. TRUSTS

A. *ASTL V. MONTREAL TRUST CO. OF CANADA*[153]

The originating action arose from an application by Montreal Trust Co. of Canada (Montreal Trust) for directions as to the out-of-court payment of $2.7 million, which related to approximately 100 trust agreements. In an attempted departure from the established "collapse" procedure, the mineral owners sought an order declaring that the subject gross royalty trusts had expired and that the monies interpled should be paid directly to the appropriate mineral owners, subject to the condition that the unit holders of each trust be notified. However, the unit holders sought an order directing the interpled funds be paid back to Montreal Trust for distribution according to the terms of the applicable gross royalty trusts, unless the mineral owners took action to collapse the trusts.

At trial, Mason J.[154] agreed with the unit holders, noting that the mineral holders sought the results of a termination order without complying with the process developed during the period of dealing with the interpled funds. That process had been developed and agreed upon by counsel for both the mineral holders and the unit holders. The trial judge refused to deal with interpled funds solely on the basis of the classification of those trusts by the trust company and in the absence of sworn evidence. Such a determination could effectively terminate the trust agreements in the absence of evidence that either side wishes to terminate.

Justice Mason directed that interpled funds be paid out of court to Montreal Trust for distribution to the appropriate unit holders, and that payments under the trust agreements resume. Mineral owners would not "have recourse to Montreal Trust, its predecessors or unit holders for monies paid out pursuant to [the] Order, nor [would] they have recourse for past royalties distributed under the terms of the [trust agreements]."[155] However, no payments would be made for 90 days after the service of the order on all mineral owners, so that they would have an adequate opportunity to contest the validity of the remaining trust agreements before the money was distributed using the established procedure.

Justice Mason's decision was appealed. Justice Hunt, in allowing the appeal, found that there were two difficulties with the decision at trial. First, it provided for the payment of monies without a determination as to entitlement to the funds. Second, it placed an "economic burden on the mineral owners to establish their claims," even though a "preliminary assessment by the trustee suggests that the trust agreements had all come to an end…."[156]

The Court directed that:

> Within six months of this order, counsel for the mineral owners shall conduct the necessary searches, prepare the necessary documents and make a collapse application as to each trust agreement in accordance with the

153 [2002] 4 W.W.R. 585, 2002 ABCA 21.
154 [2000] 2 W.W.R. 756, 1999 ABQB 872.
155 *Ibid.* at para. 53.
156 *Supra* note 153 at para. 6.

evidentiary requirements previously determined by the case management judge. Solicitor-client fees incurred for each collapse application shall be paid from the interpled funds.

Should counsel determine that such an application cannot be made with respect to a particular trust within that six-month period, any party is at liberty to make whatever application it wishes to the case management judge. From the absence of such a collapse application, the case management judge may well then be in a position to draw an inference leading to a conclusion about the continuing effect of a particular trust agreement, with resulting royalty entitlements. In the meantime, interpled funds would remain in court and future royalties will continue to be paid into court.[157]

VIII. TAX

A. *MOBIL OIL CANADA, LTD. V. CANADA*[158]

The issue in this case was whether payments made by Mobil Oil Canada, Ltd. (Mobil) to the Province of Saskatchewan (the Province) from 1977 through 1980, pursuant to the *Road Allowances Crown Oil Act*,[159] were deductible against income. At trial, it was determined that they were not deductible. Mobil appealed.

The *RACO Act* permitted the Province to collect revenue equal to one percent of the value of all oil produced in the Province. The Province was the owner of 1.88 percent of all oil produced in Saskatchewan, of which it did not automatically take delivery. Instead it reserved the right to elect to do so. The Court found that "A producer of oil for which no election was made had the right to sell the Province's 1.88 percent share and retain the proceeds of sale in excess of 1 percent of the value of the oil produced," and that, since "The Province did not elect to take delivery of its share of Mobil's oil production.... Mobil, having made the required payments under section 4 of the *Road Allowance Crown Oil Act* was entitled to sell the Province's 1.88% share of the oil it produced during those years and retain the revenue."[160]

The Crown's position was that s. 18(1)(m) of the *Income Tax Act*[161] prohibited the deduction of Mobil's payments to the Province pursuant to the *RACO Act*. For the years under appeal, s. 18(1)(m) of the *Income Tax Act* read:

> 18.(1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of
>
> ...
>
> (m) any amount (other than a prescribed amount) paid or that became payable in the year by virtue of an obligation imposed by statute or a contractual obligation substituted for an obligation imposed by statute to
>
> (i) Her Majesty in right of Canada or a province,
>
> (ii) an agent of Her Majesty in right of Canada or a province, or

157 *Ibid.* at paras. 7-8.
158 [2002] 1 C.T.C. 55, 2001 FCA 333.
159 R.S.S. 1978, c. R-23 [*RACO Act*].
160 *Supra* note 158 at paras. 4, 9.
161 S.C. 1970-71-72, c. 63.

> ...
>
> as a royalty, tax (other than a tax or portion thereof that may reasonably be considered to be a municipal or school tax), lease rental or bonus or as an amount, however described, that may reasonably be regarded as being in lieu of any such amount, and that may reasonably be regarded as being in relation to
>
> (iv) the acquisition, development or ownership of a Canadian resource property or a property that would have been a Canadian resource property if it had been acquired after 1971, or
>
> (v) the production in Canada of
>
> (A) petroleum, natural gas or related hydrocarbons, or
>
> ...
>
> from an oil or gas well or mineral resource situated on property in Canada from which the taxpayer had, at the time of such production, a right to take or remove petroleum, natural gas or related hydrocarbons or a right to take or remove metal or minerals;...

Justice Sharlow held that the appeal must fail if two conditions were met: (1) if the payments were a royalty, tax, lease rental or bonus or an amount that may reasonably be regarded as being in lieu of any such amount; and (2) if the payments were within the scope of s. 18(1)(m)(iv) or (v).

With respect to the first condition (that is, the nature of the payment), the Province argued that the payments were royalties, taxes or amounts that may reasonably be regarded as in lieu of royalties or taxes. Relying upon the following definition, Mobil argued that the payments were not royalties:

> Compensation for the use of property, expressed as a percentage of receipts from using the property or as an account per unit produced ... Royalty is share of product or profit reserved by owner for permitting another to use the property. In its broadest aspect, it is share of profit reserved by owner for permitting another the use of property. In mining and oil operations, a share of the product or profit paid to the owner of the property.[162]

The Court approved of this definition and found that it was consistent with common usage in the oil and gas industry. Justice Sharlow further stated that, in the context of contractual arrangements between landowners and oil and gas producers, a royalty is the means by which the owner of the resource shares in its production.

Mobil argued that the payments were not royalties because Mobil's right to take the oil was derived from leases that operated independently of the *RACO Act*. The leases stipulated the consideration that Mobil, as owner of the oil, must pay to the Province for the right to take the oil. As a result, Mobil's payments under the *RACO Act* were for something other than the right to take the oil from the property, and therefore were not royalties.

The Court of Appeal held that the word "royalty" as used in s. 18(1)(m) of the *Income Tax Act* is not limited to its meaning in the commercial context. Justice Sharlow stated that s. 18(1)(m) dealt fundamentally with payments to the Crown, and that the word "royalty" was

---

162 *Black's Law Dictionary*, 5th ed., *s.v.* "royalty."

"still used in Canada to describe a payment that is required by a provincial statute to be paid to the province as a share of the production of a resource."[163] However, there was no authority that suggested that the word "royalty" must be limited to amounts paid pursuant to such an arrangement. The Court therefore held that, in the context of payments to a province, the word "royalty" may describe "any share of resource production that is paid to the Province in connection with its interest in the resource."[164] The Court then found that the one percent payment was a royalty under s. 18(1)(m) of the *Income Tax Act*, even though it was the *RACO Act* that created proprietary interest.

The Court then considered whether the payments were within the scope of s. 18(1)(m)(v) of the *Income Tax Act*. Mobil argued that the payments represented the Province's net share of its 1.88 percent ownership in the oil produced and that Mobil had no rights in respect of that share. The Court found that s. 18(1)(m)(v) did not impose any conditions of ownership on the oil for which the payments were made, and concluded that Mobil had the right to take or remove the oil from the property under the leases. The fact that oil production triggered certain obligations under the *RACO Act* did not derogate from Mobil's right under the leases to take or remove the oil. The Court also concluded that the payments may reasonably be considered to relate to the exercise of Mobil's right to remove the oil from the ground. The Court noted that s. 4 of the *RACO Act* expressly tied the exercise of that right to the obligation to make the payments. As a result, the payments were within the scope of s. 18(1)(m)(v).

The appeal was dismissed, therefore, on the basis that payments made to the Province pursuant to s. 4 of the *RACO Act* were prohibited as deductions pursuant to s. 18(1)(m) of the *Income Tax Act*.

163 *Supra* note 158 at 21.
164 *Ibid.*