RECENT CASES AND DEVELOPMENTS IN OIL AND GAS LAW

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The Canadian Petroleum Law Foundation Ninth Annual Research Seminar in Oil and Gas Law followed a different format from past seminars. Whereas previous seminars had centered on various aspects of a single topic, the Ninth Annual Research Seminar was broadened to include several topics. One of the topics was the following paper on Recent Cases and Developments in Oil and Gas Law. This topic was very well received by the seminar participants and it is the intention of the Canadian Petroleum Law Foundation to continue this topic at future seminars.

A. INTRODUCTION

This paper has attempted to review some of the more current cases which have considered various areas of law affecting the petroleum industry and has made an attempt to comment on their significance. A paper of this nature may suffer from the "broad brush" treatment, but it is hoped that sufficient comment is made to prick the curiosity of oil and gas lawyers so as to encourage further analysis and consideration.

Six topics will be reviewed:

Estoppel;
Termination of Petroleum and Natural Gas Leases;
Mailing of Delay Rentals;
Arbitration and Expropriation;
Operating Agreements; and
Mineral Royalties.

B. ESTOPPEL

The cases of *Weyburn Security Company Ltd.* v. *Sohio Petroleum Company*[1] and *Canadian Superior Oil Ltd.* v. *Paddon Hughes Development Co. Ltd. and Hambly*[2] are probably the most important cases bearing on the petroleum industry in recent years. These judgments may well bring to a conclusion the pleas of Estoppel (other than Estoppel by Deed) in cases involving terminated petroleum and natural gas leases. Not only did Mr Justice Martland decide in both cases that Estoppel had not been established, but he expressed doubt that the plea of Estoppel (except perhaps Estoppel by Acquiescence) could be accepted by the courts in cases where a lease had terminated. In the *Hambly* case he stated:[3]

> Without attempting finally to determine the matter, I have serious doubt as to whether the issue of estoppel can properly be raised in the circumstances of this case. The appellants, as plaintiffs, seek a declaration that the lease is a good, valid and subsisting lease. For the reasons already given, it appears that the lease in question had terminated. It could not be revived thereafter except by agreement, for consideration, between the parties. To say that subsequent representation by Hambly could recreate the legal relations between the parties would be to say that such representation could create a new cause of action for Superior. But, subject to the equitable rule as to acquiescence, which has sometimes been described as estoppel by acquiescence, and to which I will refer later, a cause

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[1] (1970) 74 W.W.R. 626.

[2] (1970) 74 W.W.R. 356.

[3] (1970) 74 W.W.R. 356 at 360.

of action cannot be founded upon estoppel: *Low* v. *Bouverie,* [1891] 3 Ch. 82, at 101, 105; *Combe* v. *Combe,* [1951] 2 K.B. 215; *Spencer Bower and Turner on Estoppel by Representation,* 2nd ed., p. 279, para. 289.

And again in the *Weyburn* case he stated:[4]

> In the case of *Canadian Superior Oil Ltd. and Kerr-McGee Corporation* v. *The Paddon-Hughes Development Co. Ltd. and Ralph Hambly,* recently decided in this Court, but not presently reported, I expressed doubt as to whether a lease, which had terminated, could be subsequently enforced on the basis of representations or conduct occurring after its termination, unless, at least, they would amount to a fraud . . . .

And further:[5]

> It is not necessary to repeat what was said in the *Canadian Superior* case, nor it is necessary to state a final conclusion on that issue, because I agree with the judgment of the Court of Appeal that, in the present case, estoppel was not proved.

Consequently it may now only be of academic interest to review the facts of these two cases and other recent cases where Estoppel was pleaded. However, the cases are of such importance that it is incumbent on the writer to comment on them and briefly to summarize the various forms of Estoppel pleaded.

Estoppel seems to consist of four basic forms which frequently inter-relate or break-down into various sub-species. As the law of Estoppel is continually evolving it is difficult to precisely categorize these various species and sub-species. However, the following statements may be helpful in defining the forms of Estoppel pleaded in recent petroleum cases.

1. *ESTOPPEL BY REPRESENTATION*

This species of Estoppel (otherwise known as Estoppel in Pais) is the old common law form which will apply in cases of positive acts and it also covers a sub-species called Estoppel by Acquiescence which will apply to situations of inaction or silence. An oft quoted description is:[6]

> Where one person (the representor) has made a representation to another person (the representee) in words or by acts and conduct, or (being under a duty to the representee to speak or act) by silence or inaction, with the intention (actual or presumptive), and with the result, of inducing the representee on the faith of such representation to alter his position to his detriment, the representor, in any litigation which may afterwards take place between him and the representee, is estopped as against the representee, from making or attempting to establish by evidence, any averment substantially at variance with his former representation, if the representee at the proper time, and in the proper manner, objects thereto.

It will be noted that there is no element of futurity in this type of representation. It is a representation as to an existing fact or past event.

2. *ESTOPPEL BY ACQUIESCENCE*

Although Estoppel by Acquiescence is included in the above description, a more pertinent description of this sub-species is:[7]

> It has been said that the acquiescence which will deprive a man of his legal rights must amount to fraud, and in my view that is an abbreviated statement of a very true proposition. A man is not to be deprived of his legal rights unless he has acted in such a way as would make it fraudulent for him to set up those rights. What, then, are the elements or requisites necessary to constitute fraud of that

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[4] (1970) 74 W.W.R. 626 at 629.

[5] *Id.* at 630.

[6] Spencer Bower and Turner, *Estoppel by Representation,* (2nd Ed), (1966) at 4.

[7] *Willmott* v. *Barber* (1880) 15 Ch. D. 96 at 105.

description? In the first place the plaintiff must have made a mistake as to his legal rights. Secondly, the plaintiff must have expended some money or must have done some act (not necessary upon the defendant's land) on the faith of his mistaken belief. Thirdly, the defendant, the possessor of the legal right, must know of the existence of his own right which is inconsistent with the right claimed by the plaintiff. If he does not know of it he is in the same position as the plaintiff, and the doctrine of acquiescence is founded upon conduct with a knowledge of your legal rights. Fourthly, the defendant the possessor of the legal right, must know of the plaintiff's mistaken belief of his rights. If he does not, there is nothing which calls upon him to assert his own rights. Lastly, the defendant, the possessor of the legal right, must have encouraged the plaintiff in his expenditure of money or in the other acts which he has done, either directly or by abstaining from asserting his legal right. Where all these elements exist, there is fraud of such a nature as will entitle the Court to restrain the possessor of the legal right from exercising it, but, in my judgment, nothing short of this will do.

3. *PROMISSORY ESTOPPEL*

The old common law form of Estoppel by Representation was restricted to representations of existing facts. The Courts of Equity found it necessary to develop a form of Estoppel covering assurances or promises regarding the future. This form of Estoppel has become known as Promissory Estoppel and has been described as follows:[8]

> . . . Where one party has, by his words or conduct, made to the other party a promise or assurance which was intended to affect the legal relations between them and to be acted upon accordingly, then, once the other party has taken him at his word, and acted upon it, the one who gave the promise or assurance cannot afterwards be allowed to revert to the previous legal relations as if no such promise or assurance had been made by him, but he must accept their legal relations subject to the qualification which he himself has so introduced, even though it is not supported in point of law by any consideration, but only by his word.

4. *ESTOPPEL BY DEED*

Another form of Estoppel, Estoppel by Deed, or by the Covenants of the Parties, has also been resorted to in recent petroleum cases. This form can be described as:[9]

> Estoppel by Deed, then, arises where it appears from the formal writing of the parties that they have agreed to admit as true, or to assume the truth of, certain facts as the conventional basis upon which they have entered into contractual or other mutual relations.

(a) *The Weyburn Case*

In the *Weyburn* case the common law form of Estoppel by Representation and the equitable form of Promissory Estoppel were pleaded. Briefly the facts of this case are:

Petroleum and Natural Gas Lease	October 28, 1949
Expiry of primary term	October 27, 1959
Spud date of well	October 21, 1959
Completion date	November 8, 1959
On production date	Late November or early December, 1959.

In the trial decision, Mr. Justice MacPherson of the Saskatchewan Court of Queen's Bench[10] found that the lease was the same as the lease examined in *Canada-Cities Service Petroleum Corp.* v. *Kininmonth*[11]

[8] *Combe* v. *Combe* [1951] 1 All E.R. 767 at 770.

[9] Spencer Bower and Turner, *supra*, n. 6 at 146.

[10] (1968) 66 W.W.R. 155.

[11] (1964) 47 W.W.R. 437.

and decided that the lease had terminated on October 27th, 1959 by its very terms.

In addition to the above summary of facts, the following facts were tendered by the lessee to support its argument that Estoppel by Representation and Promissory Estoppel were applicable. In compliance with the terms of the lease the lessee paid and the lessor accepted royalty payments; on the demand of the lessor dated April 5th, 1960 the lessee drilled an offset well; on the demands of the lessor (which demands continued right up to the month of the trial) the lessee paid the lessor's share of mineral and production taxes; and finally, the lessor granted the lessee a surface lease to be used in drilling the offset well. The distinguishing feature of this case over previous cases in which Estoppel by Representation or Promissory Estoppel had been pleaded was the existence of positive acts or demands by the lessor on the lessee after the lease had terminated. In previous cases, the plea of Estoppel had been found barren of representation whether active, passive or promissory. In this case there appeared to be the necessary representation of an existing fact inducing the lessee to act and thereby suffering a detriment which was sufficient to plead the common law rule of Estoppel by Representation. Weyburn, under the provisions of the lease, and after its termination, demanded the drilling of an offset well and the payment of mineral and production taxes and Sohio acted in accordance with these demands. Weyburn appeared to have represented to Sohio that the lease was alive. MacPherson, J. decided at trial[12] that a representation of an existing fact had been made by Weyburn and was acted upon by Sohio to its detriment. He found that there was compliance with the governing rules of Estoppel by Representation as laid down in *Pickard* v. *Sears*[13] and *Freeman* v. *Cook*.[14]

In addition, there appeared to be a factual situation to which the equitable laws of Promissory Estoppel were applicable. Weyburn, by demanding the offset well and the payment of the taxes pursuant to the terms of a terminated lease appeared to have provided Sohio with the assurance that the lease was binding and would continue to be binding on Weyburn. Again MacPherson, J. found that there was a promise intended to be acted upon by Weyburn, which in fact was acted upon by Weyburn, and that the rules of Promissory Estoppel as laid down by Denning, J. in the *High Trees*[15] and *Combe*[16] cases applied.

However, the seemingly forceful set of circumstances which would finally break down the impregnable barrier into the haven of Estoppel did not impress either the Court of Appeal of Saskatchewan or the Supreme Court of Canada. The Court of Appeal[17] found one of the constituent elements of Estoppel missing. Hall, J.A. ruled that Sohio did not act on the demands of Weyburn because of any inducement by Weyburn, but because, believing the lease to be alive, it felt obligated to perform under the terms of the lease. As stated by Hall, J.A.:[18]

[12] (1968) 66 W.W.R. 155.

[13] (1837) 112 E.R. 179.

[14] (1884) 154 E.R. 652.

[15] *Central London Property Trust Ltd.* v. *High Trees House Ltd.* [1956] 1 All E.R. 256.

[16] *Combe* v. *Combe* [1951] 1 All E.R. 767.

[17] (1969) 69 W.W.R. 680.

[18] *Id.* at 684.

> In the instant case it may be that the words and conduct relied upon by the learned trial judge as the basis of Estoppel by Representation are not representations of an existing fact. It is not necessary to determine whether they were because the respondent, Sohio, at no time acted upon them to alter its position. It is clear from the evidence that both the appellant and the respondent, Sohio, were of the mistaken belief that the term of the lease was extended under the provisos to the *habendum* clause. The appellant made no representation which affected the operation of the *habendum* clause. All of the facts relating to the application of the clause were fully within the knowledge of the respondent.

and further:[19]

> The respondent, Sohio, held the belief throughout that the lease had not terminated. Its position was adopted prior to and apart from any alleged representation on the part of the appellant and could not therefore have been induced thereby. Estoppel by Representation cannot therefore be applied.

With respect to the finding by MacPherson, J. at trial that Promissory Estoppel could be applied, the Court of Appeal stated that whether or not a promise or assurance was made was irrelevant in that Sohio acted because it considered:[20]

> . . . it was obligated to perform them under the terms of the lease. The appellant, in requesting or demanding that the respondent, Sohio, carry out the terms of the lease, and in allowing the respondent, Sohio, to proceed as it did, simply accepted the mistaken position that the lease had not terminated. Because the appellant was not aware of the true legal position it is not now precluded from exercising its rights.

The Appeal Court then ordered a settlement by which Sohio retained the revenues it had earned to the date of the Writ of Summons, plus a recovery of its costs after the Writ was issued, as follows:[21]

> The appellant also sought an accounting of all petroleum, natural gas and related hydrocarbons removed from the land by the respondents, or damages in lieu thereof. The court has jurisdiction to grant this relief on terms which will be just and equitable to all parties involved. The respondent, Sohio, proceeded under a mistake as to its rights, and did not knowingly take an unfair advantage of the appellant's lack of appreciation of its legal rights. The respondents were first aware that their position was challenged when the writ of summons was served upon them. At that time the revenue which they had received from the sale of the production exceeded the amount they had expended. Under the circumstances, it would appear just and equitable to order the respondents to account for all benefits from production received by them after the date of service of the writ of summons upon them.

In affirming the decision of the Court of Appeal of Saskatchewan, Mr. Justice Martland stated:[22]

> I agree with the reasons of the Court of Appeal. It is quite clear that the actions of Sohio did not result from representations or conduct of the respondent. They were taken because Sohio, as well as the respondent, was unaware of the fact that the lease had come to an end before they were taken. In these circumstances, estoppel could not be established, and there is no suggestion that a new lease had been created.

It would appear that the Court of Appeal of Saskatchewan and the Supreme Court of Canada came to the conclusion that Sohio acted not because of any inducement by Weyburn, but because it mistakenly believed the contract was in existence, and as such, it had the contractual obligation to act. Hall, J.A. concluded that in order to determine the existence of an inducement, the belief of Sohio in the exis-

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[19] *Id.* at 685.

[20] (1969) 69 W.W.R. 680 at 686.

[21] *Id.* at 687.

[22] (1970) 74 W.W.R. 626 at 631.

tence of the lease had to be formulated solely on Weyburn's demands, as he stated as follows:[23]

> . . . Sohio, held the belief throughout that the lease had not terminated. Its position was adopted prior to and apart from any alleged representation on the part of the appellant and could not therefore have been induced thereby.

Before the Supreme Court of Canada, counsel for Sohio argued that if in fact Sohio had answered Weyburn's demands due to a mistaken belief in the existence of the lease, it also acted because it was induced to do so by Weyburn. In other words, Sohio argued that there were two co-existing inducements: one inducement being its own mistaken belief in the existence of the lease; and the second being the demands by Weyburn, which confirmed Sohio's belief. As is stated in Spencer Bower and Turner:[24]

> It is not necessary that the representation should be the sole or exclusive cause of the representee altering his position; it is enough that it is a cause of his doing so, provided that a real causal nexus is established. And where the action taken by the representee is obviously a natural consequence of his assuming the truth of the representation a *prima facie* inference may be drawn in favor of a causal connection without more.

It is unfortunate that the Supreme Court of Canada found it unnecessary to address itself to this seemingly forceful argument. For the first time in terminated lease cases we find a set of existing facts or positive demands as opposed to passive acts which one would imagine contained all the necessary ingredients to constitute a representation. It will be recalled that in previous oil and gas lease cases where Estoppel was pleaded, the non-existence of positive demands by the lessor appeared to be the reason why the plea was not successful. However, in this case the Supreme Court of Canada was presented with a set of active demands by the lessor but it was still not prepared to consider the demands to be the sole inducement or even a contributory inducement. Consequently, it is extremely doubtful that the plea of Estoppel will ever be used successfully.

This case and the *Hambly* case once again forcefully remind oil and gas lawyers that a *profit à prendre* once terminated can not be revived except by deed.

(b) *The Hambly Case*

In the case of *Canadian Superior Oil Ltd.* v. *Paddon-Hughes Development Co. Ltd. and Hambly*[25], Estoppel by Acquiescence as well as Estoppel by Representation were considered. The facts of this case were as follows:

Petroleum and Natural Gas Lease	June 17, 1948
Expiry of primary term	June 16, 1958
Spud date of well	June 10, 1958
Completion date	August 6, 1958
First shut-in royalty payment	August 13, 1958

Additional facts were presented by the plaintiff to support its argument that Hambly not only accepted the first shut-in royalty payment

[23] (1969) 69 W.W.R. 680 at 685.

[24] Spencer Bower and Turner, *supra*, n. 6 at 98.

[25] (1970) 74 W.W.R. 356.

after the term of the lease had expired but continued to accept shut-in royalty payments for the next six years.

A fact of some significance in this case is that the shut-in royalty was paid to the Prudential Trust Company Limited, the Trustee under a Royalty Trust Agreement. The significance of this fact will be commented upon later in this paper. A further action by Hambly which was put into argument by the plaintiff was the receipt of rental payments under a surface lease. Also it was put in evidence that Hambly, two years after the well was drilled, had advised the plaintiff that the gas pressure appeared to be dangerously high. And finally, it was mentioned in evidence that Hambly had executed an agreement as collateral security to a mortgage in which this lease was itemized as one of the leases tendered as security. In the Appeal Court judgment[26] the Court first considered Estoppel by Acquiescence. As mentioned earlier, Spencer Bower and Turner define Estoppel by Representation to include Estoppel by Acquiescence:[27]

> Where one person (the representor) has made a representation to another person (the representee) in words or by acts and conduct, or (*being under a duty to the representee to speak or act) by silence or inaction,* with the intention (actual or presumptive), and with the result, of inducing the representee on the faith of such representation to alter his position to his detriment, the representor, . . . is estopped as against the representee, from making, or attempting to establish by evidence, any averment substantially at variance with his former representation . . . [Emphasis added.]

In the Appeal Court judgment Johnson, J.A. referred to the leading case on Estoppel by Acquiescence, *Willmott* v. *Barber*[28] which enumerated the rules governing this doctrine. Essentially that case decided that the representee must have made a mistake as to his legal rights and the representor must have known the existence of his legal rights which he knows to be inconsistent with the rights claimed by the representee. As was stated in the *Willmott* case:[29]

> If he [the representor] does not know of it [meaning his own legal right] he is in the same position as the plaintiff, and the doctrine of acquiescence is founded upon conduct with a knowledge of your legal rights . . . [In addition the representor] must know of the plaintiff's mistaken belief of his rights. If he does not, there is nothing which calls upon him to assert his own rights.

These rules were qualified by Lord Tomlin in *Greenwood* v. *Martins Bank*[30] in which it was stated:

> Mere silence cannot amount to a representation, but when there is a duty to disclose deliberate silence may become significant and amount to a representation.

Johnson, J.A. found that Hambly did not know that he had the right to treat the lease as terminated and consequently he did not have knowledge of the existence of his own right which was inconsistent with the right claimed by the plaintiff. Johnson, J.A. further commented that there was no duty on Hambly to disclose to the lessee that the lease had terminated and referred as authority for this statement to *B.A. Oil Co.* v. *Kos.*[31]

In order to plead Estoppel by Acquiescence it is essential that the representor have knowledge of his legal rights which are inconsistent

[26] (1969) 67 W.W.R. 525.

[27] *Supra*, n. 6 at 4.

[28] (1880) 15 Ch. D. 96.

[29] *Id.* at 105.

[30] [1933] A.C. 51 at 57.

[31] (1964) 46 W.W.R. 141.

with the rights claimed by the representee and there must be a duty incumbent upon the representor to disclose his legal right. If either of these prerequisites is not present the doctrine of Estoppel by Acquiescence will fail as it failed in the *Hambly* case. As an alternative to the doctrine of Acquiescence, the lessee argued that Estoppel by Representation could be pleaded. As was mentioned previously in a situation where words or conduct are put in evidence to prove Estoppel by Representation as distinct from Estoppel by Acquiescence knowledge of the representor's rights is not essential. As was stated in *Sarat Chunder Dey* v. *Gopal Chunder Lala*:[32]

> The law of this country gave no countenance to the doctrine that, in order to create Estoppel, the person whose acts or declarations induced another to act in a particular way must have been under no mistake himself or must have acted with an intention to mislead or deceive.

Again the Court of Appeal considered the words and conduct of Hambly to determine if they were in fact representations inducing the representee to act. The Court found that the receipt of the rental payments and the advice by Hambly of the dangerous condition of the well were not representations. Further, it decided that the reference to the lease in the collateral security document was not a representation as the lessee was not a party to that document. With respect to the receipt of the shut-in royalties, the Court stated that the receipt of these royalties by the trustee were not receipts by an agent of Hambly. The Court stated:[33]

> While there are certain aspects of the relationship of a trustee *vis-à-vis* his beneficiary which resembles that of agent and his principal, there is no suggestion that a similar one exists between the settlor and the trustee.

Consequently, because the Court found that there were no representations, it did not have to consider whether the lessee had suffered a detriment.

In affirming the Court of Appeal's decision the Supreme Court of Canada dismissed the plea of Estoppel on the following grounds:

> Firstly, with respect to Estoppel by Acquiescence, the Supreme Court agreed with the Court of Appeal that Estoppel by Acquiescence failed because the allegation of fraud was not established;
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> Secondly, the Court rejected the plea of Promissory Estoppel on the basis that this doctrine could only be applied with respect to an existing contract and in this case the contract (the lease) had terminated prior to the alleged representation by Hambly; and
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> Thirdly, the Court ruled that on the facts there was not sufficient evidence to support the plea of Estoppel, as there was no representation by Hambly.

The rejection of Promissory Estoppel by the Supreme Court of Canada on the principle that there must be an existing contract is of great significance in pretoleum and natural gas lease cases. The Court, following its previous decision in *Conwest Exploration Company Limited* v. *Letain*[34] reaffirmed its interpretation of the doctrine of Promissory Estoppel which had been enunciated by Lord Denning in the *High Trees* case.[35] Mr. Justice Martland said that the doctrine:[36]

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[32] (1892) 8 T.L.R. 732 at 733.

[33] (1969) 67 W.W.R. 525 at 532.

[34] [1964] S.C.R. 20.

[35] [1956] 1 All E.R. 256.

[36] (1970) 74 W.W.R. 356 at 360.

> . . . assumes the existence of a legal relationship between the parties when the representation is made. It applies where a party to a contract represents to the other party that the former will not enforce its strict legal rights under it.

And, of course, in the case at bar the contract between the parties no longer existed. This interpretation of Promissory Estoppel is based on the two cases upon which Lord Denning formulated this principle, namely, *Hughes* v. *Metropolitan Rail Co.*[37] and *Birminghan and District Land Co.* v. *London & North Western Rail Co.*[38] As is stated in Spencer Bower and Turner:[39]

> It now seems reasonably clear, however, that the doctrine must be limited to modifying the existing obligations of persons who in the words of Bowen, L.J. in the *Birmingham Land* case "have contractual rights against others and who induce those others to believe that those rights will not be enforced." If Denning, J., in giving his judgment in the *High Trees* case was, as he professed, merely following existing authority, this is undoubtedly as far as that authority went.

(c) *The Murdoch and Cull Cases*

Another variation of Estoppel, Estoppel by Deed, has been considered in two recent petroleum cases—*Canadian Superior Oil Ltd.* v. *Murdoch*[40] and *Canadian Superior Oil Ltd.* v. *Cull.*[41] The facts of the *Murdoch* case were as follows:

Petroleum and Natural Gas Lease	April 22, 1950
Expiry of Primary term	April 21, 1960
Spud date of well	March 12, 1960
Rig release	April 20, 1960
Shut-in royalty payment	May 16, 1960

Although Canadian Superior at trial[42] argued that the lease had been extended beyond its primary term it withdrew that argument in the Court of Appeal and conceded that the lease had expired at the end of the primary term due to the failure to pay the shut-in royalty before the expiration date. In this connection the *Kininmonth*[43] and *Kanstrup*[44] cases were cited.

On February 8th, 1962 the parties entered into an agreement, Clause 3 of which stated:[45]

> Subject to the payment of the amount set forth in Clause 3 hereof, Agnes Murdock, for herself, her heirs, executors, administrators and assigns does hereby ratify and confirm that the said Lease is in good standing and of full force and effect.

On this basis, Canadian Superior pleaded that the laws of Estoppel by Deed applied. As mentioned earlier in this paper Spencer Bower and Turner define Estoppel by Deed or by the Convention of the Parties as:[46]

> Estoppel by Deed, then, arises where it appears from the formal writing of the parties that they have agreed to admit as true, or to assume the truth of, certain facts as the conventional basis upon which they have entered into contractual or other mutual relations.

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[37] [1877] 2 A.C. 439.

[38] (1888) 40 Ch. D. 268.

[39] Spencer Bower and Turner, *supra*, n. 6 at 341.

[40] (1969) 70 W.W.R. 768.

[41] (1970) 74 W.W.R. 324.

[42] (1968) 65 W.W.R. 473.

[43] *Canada-Cities Service Petroleum Corporation* v. *Kininmonth* [1964] S.C.R. 439.

[44] *Canadian Superior Oil Ltd.* v. *Kanstrup* [1965] S.C.R. 92.

[45] (1969) 68 W.W.R. 390 at 395.

[46] Spencer Bower and Turner, *supra*, n. 6 at 146.

and point out that:[47]

> . . . An Estoppel by Convention does not require the belief of the representee in the assumed state of facts. He believes, not that the assumption is true in fact, but that it will be treated as if it were true.

In the trial decision, Riley, J. accepted the plea of Estoppel by Deed and stated:[48]

> The common sense of the matter is that it is idle to contend that the Lease is not valid or that one cannot "breath life" into an instrument already dead. That may well be true but the parties have agreed to a different fact, namely, "the lease is in good standing and of full force and effect." There is nothing whatsoever to prevent parties from agreeing that a certain fact is so and thereafter being bound by that contract.

The Appellate Division of the Supreme Court of Alberta felt that it was "unnecessary to resort to Estoppel in order to give effect to the covenant contained in this agreement."[49] The Court pointed out that Estoppel by Deed is usually applied in situations where only by inference from statements in a contract or the recitals to a contract could a representation be found. The Court found that the contract before it clearly and unequivocally provided for an agreement between two parties that the lease was in good standing and that the Court did not have to go beyond the contractual arrangement to consider the laws of Estoppel by Deed. The *ratio* of Johnson, J.A. was confirmed by the Supreme Court of Canada.[50]

The following statement in Spencer Bower and Turner is authority for the approach taken by the Court of Appeal and the Supreme Court of Canada that the *Murdoch* case was not a case where Estoppel by Deed should be applied but was a case where the specific contractual arrangement between the parties determined the rights and obligations:[51]

> It is not necessary, nor can it be appropriate in principle, to seek to found an Estoppel on operative words in a contract. These bind the parties, if they bind them at all, by creating or evidencing contractual obligations. It is in the surrounding non-operative parts of an instrument that words founding an Estoppel are ordinarily to be discovered, and particularly (though not exclusively) in the recitals to a deed, for the very purpose of these is formally to set out matters of fact which the parties recite in a preliminary way as the basis upon which they enter into their contractual obligation.

However, in the recent decision of *Canadian Superior Oil Ltd.* v. *Cull*,[52] Sinclair, J. was required to consider an amending document which provided for inclusion of additional lands and a pooling provision after a lease had terminated. This case is also significant to the petroleum industry because of its consideration of the timing of the termination of the primary term of a lease and that aspect of the case will be dealt with in more detail in a later part of this paper.[53] However, for purposes of discussing Estoppel by Deed, the Trial Court of Alberta had to consider a document dated six months after the lease had terminated which provided in the recitals:[54]

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[47] *Id.* at 147.

[48] (1968) 65 W.W.R. 473 at 483-484.

[49] (1969) 68 W.W.R. 390 at 397.

[50] (1969) 70 W.W.R. 768.

[51] Spencer Bower and Turner, *supra*, n. 6 at 151.

[52] (1970) 74 W.W.R. 324.

[53] *Infra*, at 464.

[54] (1970) 74 W.W.R. 324 at 337-338.

> (5) the parties hereto have agreed to amend the terms of the said lease by adding a pooling clause thereto and by altering the description of the land therein set forth so as to ensure that the mines and minerals within, upon or under the said land as presently described in the said lease, are included in the said lease.

and in the operative part of the agreement:

> (4) The Lessor hereby acknowledges receipt of notices to pool the lands in the said lease with the other lands . . .
>
> (5) All other terms, covenants and conditions contained in the said lease remain in full force and effect.

The distinction between this agreement and the agreement considered in the *Murdoch* case is that this agreement was not entered into to validate a terminated lease. The agreement in the *Murdoch* case was entered into by the parties solely on the basis that the terminated lease would be considered in good standing and of full force and effect. The purpose of the agreement in the *Cull* case was to include other lands in the original lease and to provide for a pooling provision. As a secondary matter in the agreement it was mentioned that, "all other terms, covenants and conditions contained in the said lease remain in full force and effect."[55] It was essential then in this case for Sinclair, J. to determine if there was an inference from this contract that the parties had agreed to admit as true, or to assume the truth of, certain facts as the conventional basis upon which they had entered into this contract. As Spencer Bower and Turner state:[56]

> This is a matter to be resolved by ascertaining the true construction of the instrument in the surrounding circumstances. If, so construing the instrument, the Court finds that a recorded statement of facts is a part of the very thing effected by it, then the parties cannot dispute the assumed state of facts without disrupting the transaction itself.

It was the opinion of Sinclair, J. that he could draw the inference from this document that the parties were assuming that the lease was in effect notwithstanding that the lease had terminated. In the opinion of the writer, Sinclair, J. has correctly applied the laws of Estoppel by Deed to this contract and it will be interesting to watch the progress of this case through the Appeal Courts.[57]

C. TERMINATION OF PETROLEUM AND NATURAL GAS LEASES

In reviewing the above cases with respect to the application of Estoppel it was of interest to note the arguments pleaded by the lessees to the effect that the primary terms of the leases had been extended for a sufficient length of time for the shut-in royalty payments or royalty production payments to continue the leases. In none of the cases was this argument successful and these decisions provide a wealth of interpretation of the extension clauses of the freehold petroleum and natural gas lease.

The decisions of the Courts have continued to ignore or reject the argument by lessees that petroleum leases should be viewed as a business arrangement between the parties and be interpreted in a more liberal fashion. In some instances, for example, lessees have lost their leases due to late performance by a mere three or four days. The Courts refuse to recognize the extreme variables which affect the

[55] *Id.*

[56] Spencer Bower and Turner, *supra*, n. 6 at 149.

[57] The Appellate Division of the Supreme Court of Alberta, (1970) 75 W.W.R. 606, held that the lease had not terminated but had been extended beyond the primary term pursuant to the "well completion" clause, and as such, it was not necessary to consider the question of Estoppel by Deed.

scheduling of wells, the drilling days lost due to equipment failures, the delays in obtaining equipment and many other postponements caused by circumstances over which the lessee has little or no control. The Courts continue to insist that the lessee is the victim of its own procrastination by not drilling in ample time to complete its' well within the primary term. Although in certain instances there is a great deal of merit to this criticism this attitude generally fails to take into consideration the justifiable reasons for "sitting on" leases. The exploration phase of the petroleum industry is a waiting game. Good business judgment in such a high-risk business requires the lessee to wait on plays to develop in the vicinity; to drill only the most prospective structures in the early stages of exploration; and to acquire lands under lease in adjacent areas before commencing drilling. It is argued that the petroleum industry should construct leases which take into consideration these emergencies, but this is just what the industry has attempted to do in its evolution of the present petroleum and natural gas lease. As long as the Courts continue to construe leases so literally as to ignore the basic purpose of the lease it is doubtful that a lease will ever be drafted successfully to protect the interests and rights of the lessee.

In *Canadian Superior Oil Ltd.* v. *Paddon-Hughes Development Co. Ltd. and Hambly*[58] the extension provisions were identical to the provisions in the lease considered in the *Kanstrup* case.[59] Clauses 2 and 12 of this lease provided as follows:[60]

> 2. Subject to other provisions herein contained, this lease shall be for a term of Ten (10) Years from this date (called 'primary term') and as long thereafter as oil, gas or other mineral is produced from said land hereunder, or as long thereafter as Lessee shall conduct drilling, mining or re-working operations thereon as hereinafter provided and during the production of oil, gas or other mineral resulting therefrom.
>
> 12. If Lessee shall commence to drill a well within the term of this lease or any extension thereof, Lessee shall have the right to drill such well to completion with reasonable diligence and dispatch, and if oil or gas be found in paying quantities, this lease shall continue and be in force with like effect as if such well had been completed within the term of years herein first mentioned.

The primary term of this lease expired on June 16th, 1958 and the drilling rig was released on August 6th, 1958. The first payment of the shut-in royalty was made on August 13th, 1958.

It should be noted that the facts of this case are different from the *Kanstrup* case in that the well was completed after the primary term whereas in the *Kanstrup* case the well was completed shortly before the expiration of the primary term. The question to be decided was whether the shut-in royalty payment was made during the period when the primary term was being extended and to determine this it must be decided when the primary term expired, "in other words, when drilling was completed."[61]

Johnson, J.A. decided that the operations conducted on the lease after the completion date or rig release date of August 6th did not relate to drilling. After the rig release date the lessee had prepared gas analyses reports and pressure charts and had run bottom hole

[58] (1970) 74 W.W.R. 356.

[59] *Canadian Superior Oil Ltd.* v. *Kanstrup* (1964) 47 D.L.R. (2d) 1.

[60] (1969) 67 W.W.R. 525 at 528.

[61] (1969) 67 W.W.R. 525 at 529.

pressure test. Johnson, J.A. decided that such operations conducted after the completion date did not relate to the drilling of the well. As Riley, J. pointed out at trial:[62]

> On August 14th, 1958 when payment was made to the lessor there were no drilling personnel on the lease. There was no drilling equipment. There was no activity of any sort. There was nothing that took place on the Hambly lands. The requirement of "drilling operations thereon" has not been met.

Consequently due to a late payment of shut-in royalty by a matter of eight days the lessee lost a valuable gas well.

Although it is readily admitted that Johnson, J.A. was correct in deciding that the operations conducted on the Hambly lease after the completion date were not drilling operations or completion operations, the facts which Sinclair, J. was presented with in the case of *Canadian Superior Oil Ltd.* v. *Cull*[63] were not quite so straight forward.

In the Cull lease the provisions for extension were identical with the Kanstrup and Hambly leases. In this case the primary term expired on December 29th, 1957 and the rig was released on December 30th, a day after the primary term. A service rig was erected on January 2nd, 1958 and perforating, acidizing, swabbing and other operations were performed while this rig was in place. These operations were completed on January 7th, 1958. Sinclair, J. decided that these operations "were involved in drilling the well to completion." He further stated:[64]

> In my opinion, the Operator's decision to change rigs . . . cannot be said to have resulted in a breach by the plaintiff of its right to drill the well to completion with reasonable diligence and dispatch.

In the instant case the well started flowing on the date that the service rig was released, namely, January 7th, but because there was no equipment on the site to take the production the well was shut in. On January 8th, 9th and 10th a tank, separator and other equipment were erected and installed and on January 11th the well was reopened and began to flow into production. Sinclair, J. found that on January 7th the well was capable of producing oil and was completed. He also found that there was a "bona fide intention to proceed diligently to place the well on production. That intention was carried into effect with reasonable diligence and dispatch."[65] The lessee argued that the extension should continue to the time when production does in fact result, not merely to the point in time where it can or might result. The point in time where it can or might result was January 7th and the point in time when production did in fact result was January 11th. Sinclair, J. found that notwithstanding that the lessee had diligently and with dispatch attempted to place the well on production that Clause 12 "does not extend so far as to include the completion of facilities needed to treat and save the oil."[66]

Sinclair, J. considered the case of *Stevenson* v. *Westgate* in which it was stated:[67]

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[62] (1968) 65 W.W.R. 461 at 471.

[63] (1970) 74 W.W.R. 324.

[64] *Id.* at 329.

[65] *Id.* at 330-331.

[66] *Id.* at 332.

[67] *Stevenson* v. *Westgate* [1942] 1 D.L.R. 369 at 371.

> While appellants are entitled to have a construction placed upon these words that will assure them of the continued operation of any well upon their land, so that they may be assured of a reasonable return so long as respondents [lessees] continue to occupy, at the same time this is a business arrangement, and regard must be had to the reasonable requirements of the business. It is not the fair meaning of the agreement that without interruption respondents must produce a constant flow of oil in paying quantities, or lose their right to continue operating. Operations may be interrupted from causes not chargeable to respondents. There may be times in the course of the operations when it cannot be said that they are paying. In my opinion a more liberal interpretation must be placed upon the terms of the agreement than to say "if there is any such occasion the lease terminates."

Sinclair, J. did not consider this case relevant because of a different set of facts, but it is suggested that the liberal interpretation placed on the lease in the *Westgate* case is the proper interpretation which should be placed on this business arrangement between the lessor and the lessee.

Although, as previously mentioned, Sinclair, J. found that the lease, through the application of the principle of Estoppel by Deed, must be considered to have remained in effect between the parties; if there had not been such a set of circumstances resulting in the application of Estoppel, the lessees would have been placed in the very unhappy circumstance of having lost a valuable well because they failed to put the well on production immediately on the date that it was completed. Sinclair, J. through a strict interpretation of the lease paints a very bleak picture indeed.

On appeal, the Court of Appeal of Alberta held that the lease had not terminated but had been extended beyond the primary term pursuant to Clause 12, the "well completion" clause. Mr. Justice Johnson held that the question was not whether the well was flowing at the exact moment that the well was completed but whether oil can be taken and marketed so that the lessor and the lessee will be entitled to the full benefit of the well's production. He stated as follows:[68]

> It will be seen that the present problem is quite different and, reduced to its simplest terms, is: Given a ready market for oil, does the combined effect of these clauses require that production be taken the very moment that the well has been completed? I have said "the very moment" for it must be realized that in every case there will be a period, however short, while the well is connected to the gathering systems and the valves are being turned on, when no production is obtained. It is the submission of appellant's counsel that if there is such a period of time, this Court, because of what has been said in these earlier cases, must hold that the lease has not been extended. Certainly there is nothing in the evidence to suggest that, having regard to the usual oilfield practice, it would ever be possible to have production at the exact moment the well was completed. If this argument is valid, lessees would never be able to take advantage of clause 12.
>
> It is not reasonable, I suggest, to apply so stringent an interpretation.

and concluded:[69]

> Par. 12 requires that the well be drilled to completion "with reasonable diligence and dispatch", and when the procedures which follow are found to have been done in accordance with good oilfield practices and in a reasonable time and have been done "with reasonable diligence and dispatch" it is reasonable to conclude that the requirements of the lease have been complied with and the lease is accordingly extended for so long as production is continued from the well.

[68] (1970) 75 W.W.R. 606 at 610-611.

[69] *Id.* at 612.

D. MAILING OF DELAY RENTALS

Two recent decisions, with remarkable alacrity, have finally reversed the troublesome *obiter* of the *Paschke* case[70] and should be greeted with enthusiasm by petroleum company solicitors. These two cases are: *Paramount Petroleum and Mineral Corporation Ltd.* v. *Imperial Oil Limited*[71] and *Texas Gulf Sulphur Company* v. *Ballem.*[72]

(a) *The Paramount Petroleum Case*

Imperial Oil had obtained an oil and gas lease dated June 2nd, 1954, and as such, the first anniversary day for rentals was June 1st, 1955. On June 1st, 1955 Imperial Oil mailed delay rental cheques to the depository named in the lease, namely, The First National Bank, Kansas City, Missouri. Although rentals were usually mailed a month in advance of the anniversary date an error had occurred in the cheques and a second set had to be sent out. The mailing was made by ordinary, unregistered mail, postage prepaid, from the City of Calgary. Upon receipt of the cheques by The First National Bank a cashier's cheque was made payable to the order of the lessor and the date of this cashier's cheque was June 7th, 1955. The delay rental payments were not returned to Imperial Oil nor was reimbursement for these payments made to Imperial Oil by the lessor.

The plaintiff argued that because Imperial did not drill on the lands nor pay the delay rental within one year of the date of the lease the lease by its terms terminated. The operative provision of the lease was identical in form to the provision considered in the *Paschke* case.[73] It read:[74]

> PROVIDED that if operations for the drilling of a well are not commenced on the said lands within One (1) year from the date hereof, this Lease shall thereupon terminate and be at an end, unless the Lessee shall have paid or tendered to the Lessor the sum of Three Hundred & Twenty & no/100 ($320.00) Dollars, (hereinafter called the 'annual acreage rental'), which payment shall confer the privilege of deferring the commencement of drilling operations for a period of One (1) year, and that, in like manner and upon like payments or tenders, the commencement of drilling operations shall be further deferred for like periods successively.

The provision for manner of payment was Clause 22 of the lease and read as follows:[75]

> Manner of Payment:—All payments to the Lessor provided for in this Lease shall, at the Lessee's option, be paid or tendered either to the Lessor, or for the Lessor's credit in The First National Bank (Bank) at Kansas City, Missouri, or its successors, which said Bank and its successors shall be deemed the Lessor's agents and continue as the depository for receipt of any and all sums payable hereunder regardless of changes in ownership (whether by assignment or otherwise) of the said lands or of the leased substances or of the royalties or rentals to accrue hereunder unless and until the Lessee shall have been notified in writing by the Lessor to make such payments to another depository in Canada which shall be either a bank or a trust company and whose name and address shall be specified in such notice; PROVIDED that only one such depository shall be designated as aforesaid. All such payments or tenders may be made by cheque or draft of the Lessee either mailed or delivered to the Lessor or to the depository by him designated as aforesaid.

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[70] *Can. Fina Oil Ltd.* v. *Paschke* (1957) 21 W.W.R. 260 (Alta. C.A.).

[71] (1970) 73 W.W.R. 417 (Sask. Q.B.).

[72] (1970) 72 W.W.R. 273.

[73] *Can. Fina Oil Ltd.* v. *Paschke* (1957) 21 W.W.R. 260 (Alta. C.A.).

[74] (1970) 73 W.W.R. 417 at 427.

[75] *Id.* at 428.

Mr. Justice Johnson of the Saskatchewan Court of Queen's Bench found that clause 22 did not contain any ambiguity. He stated that if it was found that the mailing of the rental cheques on June 1st, 1955 did in fact constitute tender or payment of the rental within the meaning of the contract the plaintiff's case would fail on this ground.

Johnson, J. decided that there was no ambiguity in Clause 22, and as such, the document or the terms of this Clause should not be construed against the maker of the Clause, namely, Imperial Oil. He found that the Clause provided for the "mailing or delivering" to be sufficient compliance with the requirements for payment. As he said:[76]

> The words "mailed" and "delivered" obviously do not mean the same. They are alternative methods of effecting payment. Since I find no ambiguity in Article 22 of the lease there is no reason to invoke the rule which requires construction against the maker.

He further stated:[77]

> If from Article 22 of the lease it is to be taken that the mailing of the annual acreage rental cheques or drafts must be in sufficient time for delivery to be effected before the expiration of the twelve month period, there is opened up a considerable area for controversy between the parties. Suppose the lessee mails his packages in what would be considered ample time for them to be delivered to the depository or the lessor, how is he to know that delivery has taken place in time? If the lessor denies having received the mailed package before the expiration of the twelve month period, what can the lessee do? Date of delivery of any mailed package is subject to variation for many reasons but one date can be easily and definitely established and determined, namely, the date of mailing.

With reference to the *Paschke* case Johnson, J. stated:[78]

> But the remarks of Porter, J.A. in that case were *obiter* and not necessary to his decision, he having found that in any event the contract had terminated before the cheque was mailed. While the views of the Appellate Division of the Alberta Supreme Court are deserving of great respect and consideration, I, being not bound thereby, am entitled to differ from the view expressed therein. I do not deem it necessary to go outside the strict and ordinary meaning of the words employed in the document to find the intention of the parties. The words in my opinion are simple and clear and with respect I cannot follow the reasons advanced by Porter, J.A. in the *Paschke* case. I have come to the conclusion that the annual acreage rental payments were made in time by mailing before the expiration of the first year and for this reason the leases, except as hereinafter otherwise found, are in good standing.

(b) *The Ballem Case*

Coincident with the disposition of the *Paramount Petroleum* case by the Court of Queen's Bench of Saskatchewan the *Texas Gulf Sulphur Company* v. *Ballem*[79] case was ruled upon by the Appellate Division of Alberta. In the Trial Division Riley, J. following the *Paschke* case concluded that the delay rentals had not been paid in sufficient time. The facts in this case were that an oil and gas lease had been granted on October 9th, 1964. In the year 1967 the lessee on October 6th mailed by double-registered mail the delay rental cheque. October 6th happened to be a Friday and the bank, although post office notice of its receipt was placed in the bank's post office box on October 7th, did not pick up the registered package until Wednesday, October 11th. The clause providing for manner of payment was similar to the clause

[76] *Id.* at 431.

[77] *Id.*

[78] *Id.* at 431-432.

[79] (1969) 70 W.W.R. 373 (Alta. Trial); *rev'd* (1970) 72 W.W.R. 273 (Alta. C.A.).

in the lease considered in the *Paschke* case. Cairns, J. A. in his judgment disposed of the *Paschke* case with respect to the manner of payment by deciding (as did Johnson, J. in the *Paramount Petroleum* case) that the opinion of Porter, J.A. was *obiter* and not binding. In considering the "Manner of Payment" clause he stated:[80]

> When one considers this Clause it seems obvious that the lessee is given the option to do several things described as "Manner of Payment". He may deliver a cheque to the lessor or to a depository or he may take the alternate procedure of mailing a cheque to the lessor or the depository. The mailing of a cheque under these circumstances is, in my opinion, equivalent to making payment direct to the lessor or to the depository, and if this is done, as it was in this case prior to the termination of the lease, it constitutes compliance with it.

E. ARBITRATION AND EXPROPRIATION

(a) The Murphy v. *Dau Case*

Some mention must be made, if only to introduce some levity into this paper, of the case of *Murphy Oil Company Ltd.* v. *Dau.*[81] The case finally came to rest with the decision of the Supreme Court of Canada on April 28th, 1970, presumably much to the relief of the appellant and the respondent, the Government of the Province of Alberta and the petroleum industry. Briefly, the case concerned an appeal to the District Court of Alberta from an Order of the Right of Entry Arbitration Board, the decision of the District Court then being appealed to the Appellate Division of the Supreme Court of Alberta. By the time the case reached the Supreme Court of Canada neither the plaintiff nor the defendant could be certain which side had won.

The District Court held that the Order of the Board was in effect an expropriation and, on the erroneous belief that the land had been taken away completely from the owner, awarded the owner an amount based on the market value of the land. The District Court did not recognize that an Order of the Board merely confirmed (by statutory authority) the common law right of the mineral owner to enter upon the surface to win and take its minerals and failed to realize that the award made by the board is basically to compensate the surface owner for his loss of use during the time that the mineral owner is taking its minerals.

The Court of Appeal held that the value to be placed on the land was the value to the taker and not to the owner and ordered the case to be returned to the Board for determination of this additional value.[82] Specifically, Porter, J.A. was of the opinion that the drilling of the well had resulted in a "rezoning" of the land from agricultural use to commercial use and consequently the value of the land, now somewhat akin to a service station or factory, probably had escalated to major proportions.[83]

The Supreme Court of Canada reinstated the Board's award and concluded that the Board was correct when in its determination of compensation it considered the value of the land to be the value to the owner and not to the taker.

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[80] (1970) 72 W.W.R. 273 at 283.

[81] *Murphy Oil Company Ltd.* v. *Dau and Dau* (1968) 62 W.W.R. 533 (Alta. D.C.); *rev'd* (1969) 70 W.W.R. 339 (Alta. C.A.); *aff'd* (1970) 73 W.W.R. 269 (S.C.C.).

[82] (1970) 70 W.W.R. 339 at 348-349.

[83] *Id.* at 342-343.

(b) *The Twin Oils Cases*

Murphy Oil Company Ltd. v. *Dau* was the first appeal to the Courts under the amending legislation providing for appeal from orders of the Right of Entry Arbitration Board. Although the rulings of the lower courts resulted in confusion, the final decision of the Supreme Court of Canada in the *Murphy* case and the very erudite decisions of Feir, C.J.D.C. in *Twin Oils Ltd.* v. *Schmidt*[84] and *Twin Oils Ltd.* v. *Jensen*[85] have now put some order into this important part of our law. Although these cases should be examined in detail by the practitioner in arbitration and expropriation as they provide a wealth of information and insight into future rulings, it will suffice for the purposes of this paper to restrict comment to a few of the major points decided upon.

In *Twin Oils Ltd.* v. *Schmidt,* Feir, C.J.D.C. properly interpreted the basic purpose of the Right of Entry Arbitration Act when he stated:[86]

> The acquisition is not permanent. It does not carry with it the right to obtain a Certificate of Title, does not alter the municipal tax roll so as to shift the burden of taxes from the respondent nor, in my opinion, does it remove from him the obligation to pay water rates and water rights. The appellant may retain his dominion over the surface for the purpose of removing oil, gas and other minerals only so long as his undertaking is producing. In the Taber field a well may continue to produce for one year or for 25 years, or even longer in some cases. It is in accordance with this state of facts that the Board is required to set, not a purchase price, or even a rental, but compensation from the appellant to the respondent. In my view "compensation" in this setting means recompense for loss or damage.

He also correctly interpreted the function of the "value of the land" when determining compensation. In this connection he stated:[87]

> Coming to the consideration which may apply in setting compensation the first is set forth as "the value of the land." Again, it must be stressed that this evaluation is not for the purpose of setting a purchase price, but rather to furnish a solid base upon which compensation for permanent damage, adverse effect on the remaining land, severance, etc., may be estimated. Since this is an arbitration proceeding the valuing process must be governed by the principles which have been evolved over the years.

With respect to the practice of the Board in awarding annual compensation rather than a lump sum award he made the seemingly logical and practical observation:[88]

> I am unable to agree with the appellants contention that one payment should be made and no others. This appears to me to be at variance with the plan of the Act. What the producer receives is all set out in his right of entry order, based upon the Act, and he retains these rights for as long as his well is producing. While he holds the surface rights under the order the landowner is deprived of them and suffers loss and damage on a continuing basis, and is entitled to compensation accordingly. Were it otherwise the landowner on whose property a dry well is drilled and whose land is returned to him within a year would receive the same compensation as the one on whose land there is a well which produced for 20 or more years, surely a most inequitable result and one which the Act is careful to avoid.

Also to be noted in this case are the observations of Feir, C.J.D.C.

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[84] (1970) 74 W.W.R. 647.

[85] Unreported, D.C. No. 60892, Feb. 23, 1968, District Court of the District of Southern Alberta, Judicial District of Lethbridge, Feir, C.J.D.C.

[86] (1970) 74 W.W.R. 647 at 650-651.

on the qualifications of land appraisers. With respect to one gentleman's appraisal he commented:[89]

> In the case of the power company I must congratulate it on having the services of Mr. Gold. He appears to have been able to make settlements which completely ignored local conditions and which took little note of the principles laid down by the Board of Public Utility Commissioners in *Calgary Power Ltd.* v. *Hutterian Brethern of Pincher Creek,* (1961) 35 W.W.R. 227.

And again concerning another appraiser he commented:[90]

> Mr. D.J. Dick was also a witness for the appellant and a trained valuer of considerable experience. He had, however, no agricultural background and not much experience in farm valuations.

(c) *The Copithorne Case*

A recent pipeline expropriation case worthy of comment is *Copithorne* v. *Shell Canada Ltd.*[91] This case involved an appeal from an award made by the Public Utilities Board of Alberta pursuant to the Expropriation Procedures Act. Two matters of interest ruled upon by Allen, J.A. were the Blackstock formula and injurious affection. Regarding the first point, Allen, J.A. stated:[92]

> With respect to the application of the so-called Blackstock formula to the acreage in question it should be pointed out that the application of this formula has never been approved by this court and in *Interprov. Pipe Line Co.* v. *Z.A.Y. Dev. Ltd.* (1961) 34 W.W.R. 330, 80 CRTC 42, and in *Calgary Power Ltd.* v. *Danchuk, Day and Big Lake Farming Co.* (1963) 41 W.W.R. 124 (judgments delivered by Johnson, J.A.) it is expressly stated that the Blackstock formula for computation of the value of expropriated land should not be resorted to where there is evidence of other recent sales of comparable land in the district.

Allen, J.A. found that there were other recent sales of comparable land in the district and consequently the evaluation of the land should have taken into consideration these sales. He observes that the Board probably did not take these sales into consideration because they were sales not for residential or agricultural purposes but sales for a flare site and a meter station. However, Allen, J.A. was of the opinion that these sales as well as sales some distance away from the land in question which were made for country residential purposes should have been considered.

With respect to injurious affection, Allen, J.A. found that the pipeline right-of-way across this property:[93]

> . . . might very well have an adverse effect on the quantity and availability of suitable land for residential purposes and is certainly bound to have some effect on the layout of any subdivision.

Consequently he made an award of $500 under the heading of injurious affection.

It perhaps may be of some importance to note that the Board added a 50% increase to its evaluation of the property due to the fact that this was a case where a small acreage was being taken out of a larger parcel. Allen, J.A., without expressing approval of the 50% formula, was of the opinion that this was a fair and reasonable evaluation.

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[87] *Id.* at 651.

[88] *Id.* at 660-661.

[89] *Id.* at 652.

[90] *Id.*

[91] (1969) 70 W.W.R. 410 (Alta. C.A.).

[92] *Id.* at 415.

[93] *Id.* at 417.

(d) *The Swan Swanson Case*

Another significant appeal from a ruling of the Board of Public Utilities respecting pipeline expropriation is *Dome Petroleum Limited and Pan American Canada Oil Company Ltd.* v. *Swan Swanson Holdings.*[94] In this case the landowner complained at the initial hearing that a right-of-way 50 feet in width was unnecessary, but the Board held that it lacked jurisdiction to consider the question of the width of a right-of-way. It considered its sole jurisdiction related only to compensation and proceeded to grant the interim orders. An application for *certiorari* to quash the interim orders was dismissed by Sinclair, J. and following this dismissal the pipeline owners entered the land and constructed the pipeline.

The appellants, Swan Swanson, then appealed Mr. Justice Sinclair's ruling to the Appellate Division and Allen, J.A. allowed the appeal. It was Mr. Justice Allen's opinion that the Board was not simply a "rubber stamp" so far as the area, location and extent of the right-of-way was concerned. In finding that the Board definitely had jurisdiction to determine what width of right-of-way was necessary or essential he stated:[95]

> With these things in mind, and bearing in mind that no construction of sec. 45 should be such as to make it meaningless if it is possible and reasonable to construe it in a manner which will not offend the principles stated and will not result in the hardship and unfairness to landowners that could follow the interpretation placed upon it by the court below, and also having due regard to the provisions of subsec. (7) of sec. 36 quoted above, it is my opinion that sec. 45 may be fairly construed to mean that after the board has considered the actual requirements of the expropriating authority as to extent and area of the lands necessary or essential for its purposes and has arrived at a determination of these features, the land or interest or interests therein then prescribed by its order to be expropriated cannot be questioned in any proceedings under the Act, e.g., in appeals or proceedings in the nature of appeals from the board's order.

This ruling throws an entirely new complexion on applications for a right-of-way. It not only places the responsibility on the Board to question the right-of-way proposed by the pipeline owners, but it places a strong responsibility on practitioners to become much more adept and knowledgeable of the pipeline industry. Counsel will now have to be prepared to argue in each expropriation case not only the value of the land and the compensation to be paid for the taking, but must be prepared to plead for a right-of-way which is "necessary or essential" for its purposes.

An indication of what practitioners may expect can be found in the ruling of the Public Utilities Board[96] which finally disposed of the *Swan Swanson* case. Following the Appeal Court's judgment a full and complete argument was made by both parties to the Board as to the width and location of the pipeline which the Board was to determine as "necessary or essential." At the Board hearing the respondents, Swan Swanson, argued that the line should be removed and located elsewhere but the Board decided that the appeal decision of Allen, J.A. had not considered the argument that the Board had jurisdiction to change the right-of-way from one location to another. The Board referred to Section 32 (1) of the Act as authority and stated:[97]

[94] (1970) 72 W.W.R. 6 (Alta. C.A.).

[95] *Id.* at 17.

[96] Public Utilities Board of Alberta, Order No. 29729, Feb. 10, 1970.

[97] *Id.* at 22. For support of this position, *see Imperial Oil Limited* v. *Horne*, (1970) 75 W.W.R. 361.

> The Board took the view that while it could now hear any evidence relating to the width of the pipeline, it could not hear evidence having to do with changing the route or site of the pipeline.

The respondents also argued that the Board should consider the application of two areas with respect to the pipeline right-of-way. One area being narrower in width for the site of the pipeline itself and the other area wider in width which the pipeline company could use for purposes of maintaining and repairing the line. The Board again expressed the view that it did not have jurisdiction to rule on such a contention and referred to Section 36(1) as authority. The Board stated:[98]

> In the Board's opinion, accepting the applicant's requirements, in an application under this section, the Board can only consider the rights and the land that are described in the application made pursuant to Section 34 and no other rights and no other land may be considered.

The Board did accept however the respondent's contention that it had authority to determine the width of the right-of-way and the location of the pipeline within the right-of-way. In this connection its observations on this point are worthy of study as they indicate that the Board will consider each application on its merits and will give consideration to the type of land over which the right-of-way is passing. In other words, pipelines crossing through agricultural areas, forested areas, urban areas, etc. will all be given individual consideration. The Board found that in this particular instance a 50 foot right-of-way was a wider right-of-way than was "necessary or essential" and ruled that the width should be reduced to 35 feet.

F. OPERATING AGREEMENTS

During the past few months there have been several cases worthy of mention which consider disputes between parties to farmout and carried interest agreements.

(a) *The Sinclair Case*

The first case is *Sinclair Canada Oil Company* v. *Pacific Petroleums Limited.*[99] This is a case dealing with a carried interest arrangement between Act Oils Limited, the original holder of British Columbia Crown Petroleum and Natural Gas Permits, and its assignee, Pacific Petroleums. By this contract Pacific agreed to hold the Permits in trust for Act Oils as to an undivided 25% net carried interest. Act Oils had the right, within a stipulated period of time, to convert its net carried interest to a 25% participating interest by paying to Pacific a cash amount equal to 25% of all costs and expenses which Pacific was entitled to recover out of the entire proceeds of production if Act did not convert. Act Oils did not convert its net carried interest within the stipulated time.

Subsequent to the expiry of Act Oils' conversion privilege, Pacific and Sinclair entered into a farmout agreement which by later amendment gave Sinclair, among other rights, the right to a 25% participating interest in the Permits.

After Pacific entered into this agreement and the amending agreement with Sinclair it was approached by Act Oils for a renewal of its

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[98] *Id.* at 23.

[99] (1967) 61 D.L.R. (2d) 437 (Alta.); (1968) 67 D.L.R. (2d) 519 (C.A.); (1969) 2 D.L.R. (3d) 338 (S.C.C.).

conversion privileges. Pacific agreed to renew this privilege and so advised Sinclair. Sinclair consented to the renewal and in fact expressed its willingness to forego any claim for exploration costs which Pacific would recover from Act Oils if Act Oils exercised its conversion right. Pursuant to the farmout agreement with Pacific, Sinclair expended in excess of 1.8 million dollars on the Permits in exploration costs. Upon the conversion by Act Oils it paid to Pacific 25% of the 1.8 million dollars expended by Sinclair, or approximately $467,000. Sinclair then claimed from Pacific the whole of the payment paid by Act Oils but abandoned a part of this claim in the Supreme Court of Canada. Before that Court it claimed the right to 25% of the monies paid by Act Oils on the basis that it had earned a 25% interest in these monies.

Martland, J. in delivering the decision of the Supreme Court rejected the contention of Sinclair. It was his opinion that the carried interest agreement did not create a right to recover monies from Act Oils. When Sinclair obtained its interest in the Permits that interest was a 25% interest less the 25% carried interest of Act Oils. Furthermore when Sinclair obtained its farmout rights the conversion privileges of Act Oils had already expired. Martland, J. pointed out that Sinclair was not a party to the agreement between Pacific and Act Oils which renewed the conversion privileges. In his opinion Sinclair was not able to establish a contractual right to participate in the payments made by Act Oils to Pacific.

This case appears to be quite straight forward and a review of the contracts as quoted in the judgments makes one wonder why Sinclair would have commenced its action in the first place.

(b) *The Pine Pass Case*

Another significant case which is of interest to the oil industry is *Pine Pass Oil & Gas Ltd.* v. *Pacific Petroleums Ltd.*[100] This is a British Columbia case which dealt with a carried interest agreement between Pine Pass and Pacific. The case is important in that it deals with the interpretation of a carried interest clause, an express trust, a constructive trust and a fiduciary relationship. The essential clauses of the carried interest agreement which were the subject of this action were:[101]

1(b) PERMIT AREA:

The permit area shall mean the area embraced in the permits set out in Schedule A which are now in good standing and any amendments or extensions thereof or permits issued in substitution therefor or areas comprised in the said permits which shall be contained in licences or leases issued to Pacific under the Act and/or regulations.

2 DECLARATION OF TRUST:

Pacific shall hold the said Permits in trust for Pine as to an undivided seven and one-half (7½%) percent net carried interest as hereinafter defined, of the proceeds of the sale of that part of the production of oil and/or gas recovered from so much of the said lands as shall at any time hereafter be comprised within any Petroleum and/or Natural Gas lease or licence issued pursuant to the provisions of the Permits or any of them set out in the said Schedule A which remains after deducting from such production petroleum substances which may be used in developing and producing operations and in preparing and treating oil for market purposes and production unavoidably lost after deducting from such proceeds Crown Royalty and all costs, charges and expenses incurred in producing, preparing, treat-

[100] (1968) 70 D.L.R. (2d) 196 (B.C.S.C.).

[101] *Id.* at 202-203, 206 and 211.

ing and marketing such production, which proceeds are hereinafter referred to as "net proceeds of production."

3 DEFINITION OF CARRIED INTEREST:

The undivided net carried interest which Pacific under clause 2 hereof is to hold in trust for Pine is hereby defined as seven and one-half (7½%) percent of the net proceeds of production of oil and/or gas received by Pacific after deducting from such net proceeds of production seven and one-half (7½%) percent of all costs and expenses of whatever nature and kind which have heretofore or may hereafter be incurred or paid by Pacific in the maintenance of the said Permits. . . .

10 FURNISHING INFORMATION

Pine [the plaintiff] covenants and agrees to furnish Pacific [the defendant] with all surveys, geological data, reports and information held by Pine . . . relating to the lands covered by the permits to be assigned to Pacific hereunder.

The plaintiff argued that it had the right to share in the proceeds of after-acquired leases alleging that they were covered by Clause 2 as stemming from the original permits. Alternatively, they claimed that if there is not an express trust provided for in Clause 2, then, by reason of the defendant's use of the information acquired in sinking the eight original wells, together with the other information acquired in developing the whole of the property, a constructive trust should be imposed upon the income derived from these after-acquired leases. They also argued that such trusts arose out of the fiduciary relationship of Pacific to Pine Pass. Ruttan, J. stated:[102]

There is no doubt that after the corridor acreage had been subtracted from the permits, the land area in the permits has in fact been reduced by statute. Leases acquired by bidding for corridor acreage, i.e. "after-acquired leases," are not issued pursuant to the permits, for they are not part of the permits; they are acquired directly by purchase.

And further:[103]

But the permit area is reduced in size by the severance of the Crown acreage which occurs when a lease is selected in a permit area. Thereafter the leases issued to Pacific by bidding on Crown acreage cover land no longer in the permit and could not be considered as part of the "permit area."

The Court expressed its decision that there was no express trust respecting the corridor acreage and stated:[104]

But there was no obligation [on Pacific] to do anything about the lost corridor acreage once separated from the permits. Any leases acquired from the reserves were not issued "pursuant to the provisions of the permit."

The plaintiff then argued that because the legal and beneficial title to the Permits was vested in Pacific, but only upon a trust which required the utmost good faith on the part of Pacific since it alone had the power to manage and exploit the trust property, that a constructive trust existed between the parties. Lewin on Trusts was cited as authority for the definition of a constructive trust, wherein the author stated:[105]

A constructive trust is raised whenever a person, clothed with a fiduciary character, gains some personal advantage by availing himself of his situation as trustee . . . through the medium of the trust. . . .

Ruttan, J. distinquished this case from *Midcon Oil & Gas Ltd.* v. *New British Dominion Oil Ltd. and Brook*[106] when he observed:[107]

[102] *Id.* at 208.

[103] *Id.* at 211-212.

[104] *Id.* at 212.

[105] *Lewin on Trusts*, 16th ed. at 141-142.

[106] (1956) 19 W.W.R. 317 (Alta.); *aff'd* (1957) 8 D.L.R. (2d) 369 (C.A.); *aff'd* [1958] S.C.R. 314, (1958) 12 D.L.R. (2d) 705.

[107] (1968) 70 D.L.R. (2d) 196 at 214.

> There it was spelled out the parties were to be joint owners, and the product . . . was jointly owned and produced. Here the entire legal title remained always in the defendant [Pacific] and the trust, if it be one, so confined . . . to a share in the proceeds. . . .

Referring to the American case of *British American Oil Producing Co.* v. *Midway Oil Co.*[108] as a case having significant bearing on the case at bar, the Court found that there was nothing in the contract that would prevent either party from acting outside of the area for its own benefit, even though influenced in such action by information obtained within the specified area.

On the matter of confidential information and fiduciary relationship, the Court found that if Pacific had been acting in the course of its fiduciary relationship when it used the information from drilling on the Permits as an aid in bidding on the Crown acreage this would have been a violation of that relationship. However, the facts of the case were to the contrary. The Court stated:[109]

> As I have already held the defendant was not so engaged, I can only find he had no duty to account. Such information is always obtained in oil exploitations and is used, and may be used, without accounting to the carried interest holder provided the use is made outside the scope and area of the contract.

(c) *The Dynamic v. Pan American and Mobil Confrontation*

For the benefit and consideration of the draftsmen of petroleum farmout agreements it is suggested that the action commenced by Dynamic Petroleum Products Ltd. against Pan American Petroleum Corporation and Mobil Oil Canada, Ltd. concerning rights in the Rainbow area be given very serious scrutiny. This lawsuit for recovery of damages in the amount of $149,000,000 resulted from the failure to comply with the surrender provision provided for in the farmout from Dynamic to Mobil. The subject lands were subsequently farmed out to Pan American. The surrender clause provided that Mobil, upon deciding to surrender the acreage obtained from Dynamic, was obligated to give Dynamic notice in writing of its intention to surrender and, unless Dynamic consented in writing to the said surrender, Mobil was required to assign the lands it intended to surrender to Dynamic.

Briefly the facts were that Dynamic held rights to acreage in the Rainbow area which it transferred to Mobil subject to an overriding royalty and the covenant that should Mobil wish to surrender these properties or any part thereof it would first offer such lands to Dynamic. Mobil subsequently farmed out the acreage to Pan American, which agreement incorporated the overriding royalty encumbrance to Dynamic but did not carry forward the provisions respecting the surrender rights of Dynamic. Pan American subsequently surrendered certain lands to the Crown without offering these lands to Dynamic. Immediately thereafter a Rainbow discovery was made and Pan American was successful in getting the surrendered lands reinstated.

Dynamic commenced its action alleging that it was entitled to notice with respect to the surrender lands and not having received such notice it had not rejected the lands and it was therefore deemed to have acquired them. This action did not proceed to trial as a settlement was reached among the parties but the action serves to establish the necessity of carefully drafting the surrender provision and of care-

[108] 183 Okla. 475; 82 P. 2d 1049 (1938).

[109] (1968) 70 D.L.R. (2d) 196 at 218.

fully checking all previous contracts to which the predecessors in title may have been subject.

G. MINERAL ROYALTIES

There are a number of recent cases dealing with royalty rights, both the base royalty and the overriding royalty, which are worthy of examination to see if they help define the nature of a royalty interest. A brief discussion of the conflict that exists between the "interest in land" school and the "personalty" school may be found in Lewis and Thompson, *Canadian Oil and Gas*[110] and in an article in the Alberta Law Review by C. A. Rae entitled "Royalty Clauses in Oil and Gas Leases."[111]

(a) *The Bensette Case*

In the case of *Bensette and Campbell* v. *Reece*,[112] the Saskatchewan Court of Queen's Bench ruled on the nature of a perpetual non-participating royalty interest. However, as the agreement was not comparable to the modern type of royalty agreement, the judgment may be of little importance to oil practitioners. In the *Bensette* case the owner of the minerals entered into the royalty agreement with the plaintiffs in 1927. The agreement purported to convey a 6% royalty in the mines and minerals, including petroleum substances, found in, under or upon the mineral owner's lands. The royalty owner received no right to search, win and take its share of the minerals, but merely the right of access to the property and records to determine the amount of royalty. Specifically the agreement provided:[113]

> The party of the First Part covenants and agrees with the parties of the Second part in consideration of the sum of One Dollar of lawful money of Canada to it in hand paid, the receipt whereof is hereby acknowledged, to give, grant, bargain, sell, assign and transfer and by these presents doth give, grant, bargain, sell, assign and transfer unto the parties of the Second part a six per cent (6%) royalty in all the oil, gas, petroleum and mineral oils, mines and minerals acquired by the party of the First Part by the said agreement and the said several assignments which may be found in, under or upon the said lands.

Disbery, J. found that under the Saskatchewan Land Titles Act this royalty interest was "an interest in land" and not merely a personal contract between the parties. His reasoning started from the premise that as the royalty pertained to minerals *in situ*, the interest in such minerals being an interest in land, then the royalty interest in such minerals must also be an interest in land. He quoted the statement of Martin, C.J.S. in the case of *Landowners Mutual Minerals Ltd.* v. *Registrar of Land Titles* as follows:[114]

> So long, however, as oil and gas remain in the earth they are an interest in land and belong to the owner of the surface unless excepted from his title, and he may transfer ownership just as in the case of other minerals.

Secondly, he ruled that the mineral owner had the right to convey a fractional interest in minerals *in situ* and this is in fact what was done. Referring to the case of *Re Publix Oil & Gas Ltd.; Re Can. Credit Mens Trust Assn. and Merland Oil Co. of Canada*[115] and

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[110] Lewis and Thompson, *Canadian Oil and Gas*, Vol. 1, para. 106.

[111] Rae, *Royalty Clauses in Oil and Gas Leases*, (1965) 4 Alta. L. Rev. 323.

[112] (1969) 70 W.W.R. 705.

[113] *Id.* at 708.

[114] (1952) 6 W.W.R. 230 at 238.

[115] [1936] 3 W.W.R. 634.

to *Corpus Juris Secundum*[116] he defined royalty to include not only the reservation of a fractional interest of production but applied the term to a "direct grant to a third person."[117]

He concluded by referring to the operative words of the agreement, "doth give, grant, bargain, sell, assign and transfer", to enforce his opinion that by this contract the plaintiffs had acquired a fractional 6% interest in the minerals both *in situ* and upon severance. In this connection he properly distinguished this agreement from the usual base royalty reserved from the grant of a *profit a prendre* but in so distinguishing he made the rather disturbing observation as follows:[118]

> In none of the leases and contracts before the Courts in these cases are found the significant operative words, 'bargain, sell, assign and transfer' which appear in [this contract]...

It is hoped that decisions in the future will not categorize every royalty interest whether a base royalty interest or an overriding royalty interest as an interest in land simply because such royalty interest may have been created by operative words similar to the Bensette contract. Surely such operative words do not in themselves determine the nature of the royalty interest. The royalty contract in its entirety must be analyzed to determine the true nature of the interest.

(b) *The Emerald Case*

Another case which sheds little or no light on the issue of determining the nature of a royalty interest is the case of *Emerald Resources Ltd.* v. *Sterling Oil Properties Management Ltd.*[119] This case was concerned with an overriding royalty interest. Allen, J.A. stated that due to the lack of essential evidence[120] he was not able to rule on this point and in fact found that for other reasons[121] it was unnecessary to rule on the matter. However, he did make the following observation which was definitely *obiter:*[122]

> It is in my opinion at least doubtful that an overriding royalty of the type claimed by respondent is "an interest in land."

Although it is difficult to determine with any degree of certainty the basis for this *obiter* (and with fairness to Allen, J.A. it may be unwise to read too much into his statement) it appears that he concluded from the case of *Berkheiser* v. *Berkheiser and Glaister*[123] that the holder of a *profit a prendre* did not acquire title to oil and gas until it was captured and consequently a royalty on the produced substances, now a chattel, would be an interest only in a chattel. As the leases had not been tendered in evidence Allen, J.A. was not able to determine the nature of the royalty on the substances produced pursuant to these leases.

(c) *The Harrington & Bibler Case*

The case of *Harrington & Bibler Ltd.* v. *M.N.R.*[124] is of interest as

[116] Vol. 58 at 536.
[117] (1969) 70 W.W.R. 705 at 711.
[118] *Id.* at 726.
[119] (1969) 3 D.L.R. (3d) 630.
[120] *Id.* at 642.
[121] *Id.* at 643.
[122] *Id.* at 640.
[123] [1957] S.C.R. 387.
[124] (1966) 42 Tax A.B.C. 374.

it appears to be the first time that the Tax Appeal Board was required to define the nature of a royalty interest for purposes of the Income Tax Act. It also is of interest as it contains some delightful commentary on "the inexact language sometimes employed in the West in documents relating to the oil-well industry."[125] The Appellant was the holder of an overriding royalty of "one percent (1%) of all oil, gas, casinghead gas, gasoline and other hydrocarbon substances which may be produced, saved and sold by Assignor from the above described premises under and pursuant to the terms and provisions of the above described petroleum and natural gas lease . . ."[126]

The Appellant had deducted depletion allowance on certain royalty receipts pursuant to Section 1202(1) of the Income Tax Regulations. The Minister took exception to these receipts being classified as royalty income and claimed that this revenue was instead a method of payment for services rendered. The Board, referring to *M.N.R.* v. *Waintown Gas and Oil Co. Ltd.*[127] used the following definition of royalty:[128]

> . . . I think that perhaps as good and concise a one [definition] as any is that a royalty is a payment, measured by production, for the temporary or complete cession of some right or interest in property.

The Board then allowed the deduction under Section 1202(1) of the Income Tax Regulations.