ALBERTA, OIL, AND THE CONSTITUTION

DAVID E. THRING*

This paper examines the constitutionality of legislation enacted by Alberta to assert its sovereignty over petroleum resources in the province. The legislation is examined in the context of the division of powers under the B.N.A. Act and recent court decisions.

I. INTRODUCTION

In recent years the province of Alberta has moved to assert its sovereignty over the petroleum resources found within its borders. This move was prompted by various political and economic considerations[1], and has produced a comprehensive legislative scheme which extends provincial control to virtually every portion of the petroleum industry. In its entirety, this scheme encompasses the rights to grant oil leases, to regulate production from those leaseholds, to market and price oil once extracted, and to take sizable royalties from oil producers. These are broad and substantial legislative powers. They mark the extension of provincial sovereignty over a multinational industry and over a product which is, for the most part, destined for extra-provincial markets. Yet, interestingly, these regulatory powers have been widely accepted in the private sector and in Ottawa without serious legal dispute or judicial review.[2]

In a federal setting this comes as something of a surprise. Legislative authority in Canada is divided between the two levels of government under the scheme adopted in the British North America Act of 1867. Generally, developments and changes in the locus of legislative power might be expected to spark some constitutional debate, and such a debate could conceivably find its way to the courts. Although this has not been the case in Alberta, it is not necessarily because the constitutional issues are closed and or because Alberta's legislative scheme is considered beyond legal reproach. On the contrary, the various pieces of petroleum legislation enacted over the years by the province of Alberta raise several difficult and as yet unresolved constitutional problems.

This paper examines a number of these constitutional problem areas. Such a discussion may be of strictly academic appeal, since only as a last resort would Alberta and the federal government, in any showdown or struggle over changing control of the petroleum sector, take the matter

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* Third year student, Faculty of Law, University of Toronto, and recipient of the Foundation's 1977 Student Award. The author is grateful to Prof. A. R. Thompson of Vancouver, whose comments and criticisms on an earlier draft were of great assistance.

1. In the early 1970's, the rapidly rising price of oil and the discovery that oil was in short supply worldwide, resulted in new economic and political pressures on the Alberta government. As world oil prices rose, both federal and provincial governments moved to capture shares of the windfall profits accruing to oil production. For a complete account of these developments, *see* P. Tyerman, *"Pricing of Alberta's Oil"* (1976) 14 *Alta. L. Rev.* 427.

2. Compare the situation in Saskatchewan where the royalty provisions of the Oil & Gas Conservation, Stabilization & Development Act (1973) were found constitutionally invalid by the Supreme Court of Canada after lengthy litigation. *Canadian Indutrial Gas & Oil Ltd.* v. *The Government of Saskatchewan* (1977), 80 D.L.R. (3rd) 449 (hereinafter referred to as "CIGOL").

to the courts. Oil resource and energy management are such important political topics that the ultimate allocation of legislative power in these areas will be hammered out in political arenas[3], and not left to the courts. But recognizing this does not negate the practical gains to be had from even a cursory assessment of the major constitutional issues. By examining and testing the constitutional validity of the Alberta legislative scheme, weaknesses in the legislation, which members of the private sector may choose to attack, may be exposed; this argument applies particularly to the province's royalty laws, which have been cast into doubt by the recent ruling of the Supreme Court of Canada in the CIGOL case.[4] Furthermore, there is positive value in any clarification of the repective bargaining positions under the B.N.A. Act of the two levels of government in their ongoing confrontations over energy policies and priorities. Finally, discussing the constitutional strengths and problem areas of the existing provincial scheme may allow us to forecast its resilience in the face of possible future federal initiatives, should the energy situation become critical. In short, the question of constitutional validity is by no means insignificant or unimportant.

Yet for all its importance, the constitutional status and well-being of Alberta's oil legislation is not easily determined. One might expect that a study of the decisions, precedents and assorted doctrines which comprise our constitutional law would yield a clear understanding of the division of legislative power over petroleum. But the provincial legislative powers over the petroleum sector would be difficult enough in the context of what is, according to one academic, the pervasive problem of constitutional law -- drawing a dividing line between provincial powers over property on the one hand and federal powers which necessarily contemplate some interference with property on the other.[5] But the issues here present a special variation of this more general problem; the division between Alberta's power to control a provincially owned resource and the various heads of federal power affecting a resource industry, notably the trade and commerce power, must be considered. Surprisingly, this problem of separating jurisdictions over natural resources has seldom come before the courts. Furthermore, on the few occasions when it has, the courts have usually adopted the expedient of ruling only on the specific matter in question and have not attempted to define the general scope of federal and provincial authority.[6] The combined effect of the lack of litigation and the reluctance of the courts to set broad parameters[7] has left the issue of legislative control over the petroleum sector in a highly uncertain state.

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3. Examples of this political approach include federal-provincial tax agreements and equalization schemes.

4. *Supra*, n. 2.

5. P. W. Hogg, *Constitutional Law of Canadda* (1977) 393.

6. M. Crommelin, *"Jurisdiction over Onshore Oil and Gas in Canada"* (1975) 10 *U.B.C.L. Rev.* 86 *See* also the recent unreported decision of the Supreme Court of Canada in *Central Canadian Potash et. al.* v. *Government of Saskatchewan.*

7. The courts have been criticized for failing to define the broad limits of federal and provincial power. *See e.g.* P. C. Weiler, *"The Supreme Court and the Law of Canadian Federalism"* (1973) 23 *U.T.L.J.* 307. This criticism seems a little harsh. One must not forget that the courts are constrained by the B.N.A. Act, and that much of the blame for the uncertain division of legislative powers lies with the uncertainty of our 100 year old constitution.

This paper commences with a discussion of the province's legislative powers under s.92(5) of the B.N.A. Act, the constitutional cornerstone of Alberta's legislative scheme. The paper then considers a number of the principal pieces of petroleum legislation and discusses whether their provisions come within provincial legislative competence. It concludes with some remarks concerning the potential under the constitution for federal initiatives in the petroleum sector.

II. THE SCOPE OF S.92(5)

It is to Alberta's credit that, in the midst of the uncertainty described above, the province has taken the initiative and expanded its legislative powers. From both an economic and political standpoint, it was inevitable that one or both levels of government would take on a greater role in managing the oil industry. Alberta moved first,[8] arguing that it must act to protect its proprietary interests. Indeed, this theme of ownership and proprietary rights runs through the entirety of the Alberta legislative scheme. The Alberta position is that the province is the undisputed owner of the unsold petroleum resources with its borders. Under s.92(5) of the B.N.A. Act, the legislature of Alberta is empowered to make laws in matters relating to the "Management and Sale of the Public Lands belonging to the Province". The province contends that publicly owned petroleum resources are caught by s.92(5) and that in its capacity as the owner of those resources, it may manage, control, and dispose of them as it sees fit. Reduced to its barest components, this is the constitutional foundation on which the Alberta legislation scheme is built.

There is no question that the Crown in right of Alberta is the owner of the province's unsold petroleum resources. Although the Dominion Parliament retained control over those resources when Alberta joined Confederation, a 1930 agreement transferred the entire Crown interest to the province, namely, complete jurisdiction over Crown lands, mines and minerals (precious and base) and the royalties derived therefrom.[9] The property made subject to provincial control was public property, and not private freehold interests.[10] But because the Dominion from 1887 onwards followed a policy of reserving mineral rights to the Crown in land grants, the 1930 transfer of the Crown interests involved a significant volume of publicly owned oil rights. In fact, today fully eighty percent of Alberta's petroleum resources *in situ* are owned by the province.[11]

There is, however, some question as to the limit of the province's powers under s.92(5) as the owner of these vast resources. It is evident that the term 'public lands' should be construed to include all incidents to land and, in particular, mineral and resource interests.

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8. The legislation was enacted in a special sitting of the legislature known as the "Energy Session", which commenced in December 1973.
9. The Alberta Natural Resources Act, S.C. 1930, c. 3. This put Alberta on the same footing as the original members of Confederation whose titles to Crown properties and resources were confirmed by ss. 109 & 117 of the B.N.A. Act.
10. *A.-G. Ont.* v. *Mercer* (1883), 8 App. Cas. 767.
11. Crommelin, *supra* n. 6 at 92. For a detailed history of the Crown interest in resources, *see* G. V. La Forest, *Natural Resources & Public Property Under the Constitution* (1969).

Judicial interpretations of the term 'lands' in s.109 of the B.N.A. Act[12] and the term 'public lands' in the agreement which brought British Columbia into Confederation[13] suggest that this is the proper approach. But s.92(5) authorizes the province to make laws in matters coming within the 'management and sale' of those public lands, and it is the meaning and extent of the words 'management and sale' which is today an open issue. Understandably, the province favours a broad interpretation of these words. However, the limits of provincial authority under s.92(5) have not been conclusively tested or determined in the courts and there is some indication that the ambit of provincial power under s.92(5) may not be as broad as Alberta contends.

A. *The Case Law*

The few cases in which the courts have actually considered provincial legislative powers under s.92(5) are not very illuminating. In the *Fisheries* case of 1898,[14] the Privy Council considered the scope of s.92(5) in relation to fisheries, a fairly narrowly defined class of subjects reserved to the Dominion Parliament under s.91(12). Their Lordships recognized the provincial right under s.92(5) to dispose of fisheries which were the property of the province, but stated that the province's rights of disposition must conform with valid Dominion legislation:[15]

> The terms and conditions upon which the fisheries which are the property of the province may be granted, leased or otherwise disposed of, and rights which consistently with any general regulations respecting fisheries enacted by the Dominion Parliament may be conferred therein, appear proper subjects for provincial legislation, either under class 5 of s.92, "The Management and Sale of Public Lands" or under the class "Property and Civil Rights".

Thus the rule apparently laid down in the *Fisheries* case is that the rights and conditions accompanying any grant, lease or other disposition of Crown property must be consistent with valid federal laws. The decision obviously did not give an exhaustive definition of provincial powers under s.92(5). It made no reference whatever to the province's management functions (if any), speaking only of the disposition or sales powers.[16] Furthermore, their Lordships did not consider the possibility of a province attempting under its powers of 'management and sale' to impose conditions and terms which amounted to regulation in a federal legislative field that happened to be vacant. Overall, it appears that the *Fisheries* decision said very little about the scope of 92(5).

In a 1923 decision, the Privy Council again considered s.92(5), but the case is of dubious authority. In the *Brooks-Bidlake* decision[17], a provincial act validating a term in Crown timber licences which stipulated that no Chinese or Japanese labour was to be employed by the licensee was held *intra vires* the province. Though legislative powers

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12. *A. G. Ont.* v. *Mercer, supra* n. 10.
13. *A.-G. B.C.* v. *A.-G. Can.* (Precious Metals) (1889), 14 App. Cas. 295. *See also* Crommelin, *supra* n. 6 at 101-2.
14. *A.-G. Can.* v. *A.-G. Ont.* (Fisheries), [1898] A.C. 700.
15. *Id.* at 716.
16. Crommelin, *supra* n. 6 at 103.
17. *Brooks - Bidlake and Whittal, Ltd.* v. *A.-G. B.C.* [1923] A.C. 450.

over 'naturalization and aliens' are vested in the Dominion under s.91(25), the provincial statute was held valid under s.92(5). Yet the actual *ratio decidendi* of the decision is not clear. The court acknowledged the existence of valid federal legislation, the Japanese Treaty Act, which conflicted with the provisions of the provincial statute.[18] The Privy Council then inferred that because of the federal treaty, employment of Japanese could not be prohibited by the provincial statute; however, because no similar piece of federal legislation protected Chinese, the province could effectively prohibit the employment employment of Chinese by attaching conditions to that effect to the Crown licences. If *Brooks-Bidlake* can be considered reliable, it suggests that a province may, in disposing of its resource assets, attach conditions of sale or lease which pertain to matters coming under federal heads of power provided that there are no existing federal laws in the area. In other words, the constraining limit to provincial powers under s.92(5) is not the limitation posed by the scope of valid federal powers in themselves, but rather the existence of federal legislation alone.

This proposition was cast into doubt when, one year later, the entire matter was brought again before the Privy Council. On a constitutional reference concerning the same pieces of legislation[19], their Lordships refused either to endorse or rescind their earlier decision, but held the provincial statute invalid on different grounds. This later decision left considerable doubt as to the authority of the first *Brooks-Bidlake* judgment.

Another case involving Crown timber licences, heard by the Ontario Court of Appeal some twenty years before *Brooks-Bidlake*, raised the same issues in less complicated circumstances. In *Smylie* v. *The Queen*[20] a licensee of the provincial government contested a contractual condition attached to his licence to cut timber from Crown lands. The condition stipulated that the timber should be processed in Canada, and the Ontario Court of Appeal held that the provision was *intra vires* the province under s.92(5). The court reasoned that the province has the same rights in respect of Crown lands as any other proprietor in the disposal of its property — that is, the authority "to attach to the contract a condition not impossible of performance, or unlawful *per se* or prohibited by any existing law".[21] The court expressly rejected the argument that the condition infringed on the federal trade and commerce power. Thus *Smylie* apparently supports the proposition that the single constraining factor on the exercise of ownership powers under s.92(5) is the existence of valid federal legislation. Moss J. A. felt that so long as the conditions or rights attached by the province to its sale or lease or licensing agreements do not violate existing laws, then the conditions are binding.

This decision is considered to be the basis for Alberta's position that the scope of s.92(5) must be broadly interpreted. It is the only decision in which the powers of 'management and sale' were considered

18. *Id.* at 458.

19. *A.-G. B.C.* v. *A.-G. Can.* (Oriental Orders in Council Reference), [1924] A.C. 203.

20. (1900), 27 O.A.R. 172.

21. *Id.*, per Moss J.A. at 192.

in relation to the federal 'trade and commerce' power and its outcome has been defended as a case of the general provision of 'trade and commerce' giving way to the more specifically designated class of subjects in s.92(5).[22] Yet for all its importance as part of the constitutional underpinnings of the Alberta legislative scheme, the principle enunciated in *Smiley* — that provincial powers under s.92(5) are constrained only by existing federal legislation — is fairly suspect.

There are several reasons for this. The case itself stands alone. It is only a Court of Appeal decision as was made without reference to other judgments. It is a decision to which a later and similar Privy Council case makes no reference. It stands as a brief answer to an issue which the Privy Council, on a judicial reference, considered too thorny to touch, and on which the Supreme Court split evenly.[23] But more importantly, there are a number of indications that, if the same fact situation were before the Supreme Court today, the outcome would be different.

First, there is the contention by Moss J.A., widely supported in Alberta, that the province enjoys the same rights of disposition as a private owner. This is arguable. The province of Alberta, like any government, has special status in commercial transactions: it is both the legislator working in the public interest and the proprietor making a conveyance. This is a dual status to which the government is quick to point when it is in its interest to do so.[24] The two functions are not mutually exclusive; the province cannot shed its legislative responsibilities, and their attendant constitutional limitations, by assuming the guise of a private proprietor. Secondly, the decision in *Smiley* runs contrary to an established tenet of constitutional law, that Parliament's failure to legislate to the full limit of its powers does not have the effect of augmenting the powers of the province.[25] Finally, the outcome of the *Smiley* case makes a mockery of the division of legislative power under the constitution. Because there was no existing federal law governing the export of timber, the Court of Appeal was content to let the province use a conditional grant under s.92(5) to prohibit the export of unprocessed timber. Such a prohibition was clearly a colourable attempt to regulate international trade; it should have been struck down as a clear infringement of the 'trade and commerce' power.

One cannot help but think, therefore, that the *Smiley* judgment would not fare well before the present Supreme Court, which has expanded the federal 'trade and commerce' power. It is conceivable that in assessing the scope of provincial powers claimed under s.92(5), the Supreme Court would apply the same test which the courts have used since 1957 to assess provincial powers under the other heads, namely s.92(13), 'property and civil rights' and s.92(16), 'matters of a merely

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22. Crommelin, *supra* n. 6 at 106, discussing the application of a basic interpretive principle borrowed from A.S. Abel, *"The Neglected Logic of 91 and 92"* (1969 19 *U.T.L.J.* 487 at 510.

23. *Re Employment of Aliens*, [1922] 63 S.C.R. 293.

24. As will be discussed later, Alberta claims the right to unilaterally amend its leases. Such a power exercised by a private party would be clearly invalid under contract law, but the province claims to have a special status.

25. *Hogg*, *supra* n. 5 at 95.

local or private nature'. That test was succinctly put by Kerwin C.J. in the *Ontario Farm Products Marketing Act* reference[26]; it states that a provincial statute which aims at the regulation of trade in matters of interprovincial or international concern is beyond the competence of the provincial legislature. The Supreme Court has applied this test repeatedly in the numerous marketing board cases[27], and has established certain principles governing its use. First, the courts must look through the "form" of the impugned statute, to consider its "substance" or practical effect; each statute must be examined in relation to its own facts.[28] Secondly, for a provincial statute to encroach on the federal 'trade and commerce' power, it must be clearly "in relation to" extra-provincial trade; it is not sufficient that there is some tangential effect on such trade.[29] Finally, the process of determining the limits of provincial power over intraprovincial trade is a subtraction from the general trade regulatory powers contemplated in s.91(2).[30] The trend discernable from the marketing board cases is that the Supreme Court has expanded the federal 'trade and commerce' power, and given a correspondingly narrow interpretation to the provincial heads of 92(13) and 92(16).[31] It is unlikely that the proprietary or conservation elements of s.92(5) will alter the trend if and when that section is read against s.91(2).

It can be argued in conclusion that if the *Smiley* case were to be heard today by the Supreme Court, its outcome might be different. The court would recognize that by setting certain conditions to Crown leases, the provinces assert their particular interests in the regulation of various natural resource industries. But if the purpose of those lease conditions, or more accurately, if the purpose of the statutes from which those conditions originated,[32] in pith and substance is aimed at the regulation of interprovincial of international trade and commerce, then they are arguably beyond provincial competence. As the marketing board cases indicate, the importance of this test in the resolution of a future constitutional dispute cannot be overlooked.

On the whole, this analysis of the case law suggests that the limits of the provincial powers of 'management and sale' are largely undefined. More specifically, it is open to the courts to find that the provincial power to attach binding conditions to its dispositions of Crown lands should be limited to matters otherwise within provincial competence: the conditions should have to stand by themselves as valid provincial regulations and not encroach, in so far as they regulate

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26. [1957] S.C.R. 198.

27. *See e.g. A.-G. Man.* v. *Burns Foods Ltd.*, [1975] 1 S.C.R. 494; *A.-G. Man.* v. *Man Egg & Poultry Assoc.*, [1971] S.C.R. 689; *Carnation Co. Ltd.* v. *Quebec Agriculture Marketing Board*, [1968] S.C.R. 238.

28. *Carnation Co. Ltd.* v. *Quebec Agriculture Marketing Board*, *id.* at 252.

29. *Id.*

30. *A.-G. Man.* v. *Man. Egg and Poultry Assoc.*, *supra* n. 27 at 709, per Laskin J.

31. Crommelin, *supra* n. 6 at 100.

32. It has been suggested that the province, as proprietor of Crown lands, has no power to dispose of mines and minerals other than in accordance with the provisions of the provincial legislation dealing with the disposition of Crown mineral rights. G. A. Holland. *"The Federal Case"* (1964) 3 *Alta. L. Rev.* 393. In a constitutional challenge, it is most likely that the enacting legislation itself would be before the courts, and not the actual leases or lease conditions.

trade in an exported commodity, on the federal sphere. It may be decided that the scope of provincial power under s.92(5) is not limited solely by existing federal legislation, as the *Smiley* decision suggests, but rather by the ambit of the full federal power of s.91(2), particularly as it is interpreted by the Supreme Court.

B. *The Interest Created*

Whatever the proper approach to determining the scope of provincial authority under s.92(5), the powers of 'management and sale' are the crucial, if limited, underpinnings of the Alberta legislative scheme. In practice, the actual sales or leasing transactions, made by the Crown and subject to whatever provisions the province has authority to dictate, are the instruments through which the province's legislative powers are brought to bear. In the sale or lease agreement the point at which title to the petroleum passes away from the Crown marks the undisputable end to provincial powers of 'management and sale'.[33] Once property passes, the sale is complete and the oil no longer fits the description of 'public lands belonging to the province'.[34] Thus, in determining the practical limitations to Alberta's powers under s.92(5), the nature of the interest conveyed by the province, and the time at which title is relinquished, are important considerations.

The standard agreement reached between the Crown and the oil producers is a ten year lease. The Crown enters the agreement under the authority of the Mines and Minerals Act,[35] which states that a lease grants the rights to the petroleum which is the property of the Crown in the given location and subject to any exceptions expressed in the lease.[36] The Act says nothing more about the nature of the interest created by the lease. The conveyance may, according to the particular agreement, be a freehold interest, a *profit à prendre*, or some lesser contractual right, such as an exclusive or irrevocable license. Each differs according to the quality of the title retained by the province.

A freehold interest conveyed by the province (the lessor) transfers the lessor's complete title to the petroleum resources *in situ* on a given property. The lessor may or may not retain the surface rights in such a transaction, but the lessor clearly relinquishes title to the property's oil.[37] At the other extreme, the province, wishing to retain complete title to its petroleum resources, could grant the oil producer an exclusive licence, for example, a licence which grants an exclusive right to drill a well and to extract petroleum, but does not include a conveyance of title to that petroleum.[38]

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33. This is subject to the overriding consideration that the province reserves the right to change the terms of the lease after it has been signed. The power to alter the terms of the grant is discussed in the next section.

34. Crommelin, *supra* n. 6 at 116.

35. R.S.A. 1970, c. 238, as amended.

36. *Id.* s. 121.

37. This was the type of Crown interest granted before 1887. *See* discussion following n. 10, *supra*.

38. This is in fact the type of conveyance made under the Alberta reservation system. *See* Mines & Minerals Act, *supra* n. 35, s. 9. A reservation is a device used by Alberta to stimulate exploration.

The third type of conveyance is the *profit à prendre*. This is a proprietary interest which is defined as "a right to take something off another person's land".[39] Generally, the thing to be taken off must be part of the land and, at the time of taking, must be susceptible of ownership.[40] The *profit à prendre* does not involve a conveyance of title to the thing, in this case the petroleum, *in situ*; rather it assigns a right to enter another's property (similar to a licence) and work, win, recover and remove the petroleum from the property. It does not necessarily exclude the owner from also working and recovering the profit[41], but it does convey title to the things (petroleum) recovered by the lessee. It is apparently the act of recovery and the taking of physical possession which solidifies the title.[42]

The vagueness of Mines and Minerals Act forces us to consider the lease document itself,[43] in order to determine what type of interest the Crown has conveyed. In compliance with the general requirements of contract law, the courts must look to the intentions of the parties from the words of the lease. The standard granting clause reads:[44]

> ... in consideration of the rents and royalties hereinafter provided and subject to the terms and conditions hereinafter expressed, Her Majesty hereby grants unto the lessee in so far as the Crown has the right to grant the same exclusive right to explore for, work, win and recover petroleum and natural gas within and under the lands more particularly described as follows . . , together with the right to dispose of the petroleum and natural gas recovered,

While the clause is imprecise, the basic requirements of the *profit à prendre* interest are present, namely, the conveyance of a right to recover petroleum and the right to dispose of that petroleum once recovered. It would appear that the parties intended to create a *profit à prendre* and not a mere licence. However, the nature of the interest conveyed in the standard agreement has never been judicially determined.[45] Should the issue come before the courts, it will likely be held that the standard government lease creates a *profit à prendre*.

It follows that the producers, as Crown lessees and holders of *profit à prendre* interests, take title to the non-royalty share of oil produced once the oil has been extracted. The province, as lessor, retains title to the oil *in situ*, to its royalty in kind held by the producer, and to the reversionary rights on termination of the grantee's interest. Thus the only element of the province's original proprietary interest which is severed once oil is extracted is the title to the non-royalty share of production. Once that title is severed, the provincial powers under s.92(5) are terminated, at least with respect to the non-royalty share in the hands of the producer. Furthermore, it could be argued that, while the Crown retains title to its royalty in kind, that title is no longer to 'public lands' or incidents to land, but rather to chattels. Thus the Crown royalty share may also be beyond the powers

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39. 14 *Halsbury's Laws* (4th ed. 1974) 240.
40. R. E. Megarry and H. W. R. Wade, *The Law of Real Property* (4th ed. 1975) 822.
41. *Lowe* v. *J. W. Ashmore Ltd.*, [1971] 1 Ch. 545, at 557.
42. Thus it is more likely that title passes to the oil lessee once the oil is extracted and the lessee takes physical possession, rather than when the pool is tapped.
43. *See* Holland, *supra* n. 32 as to whether the Crown can dispose of its property without clearly specifying the enabling legislation what type of interest is conveyed.
44. M. Crommelin, *"Government Management of Oil and Gas"* (1975) 13 *Alta L. Rev.* 146.
45. In *Berkheiser* v. *Berkheiser*, [1957] S.C.R. 387, it was found that the lease generally in use between private parties created a *profit à prendre* interest.

contemplated in s.92(5). In sum, the Crown grant, by its very nature apparently limits the province's regulatory powers, under s.92(5), to the production process prior to the moment of extraction.

C. *The Power to Unilaterally Amend*

The province has, however, conceived of a method by which it can, under s.92(5), regulate in the post-extraction process. In the standard lease ageement the province reserves the right to make unilateral amendments to the lease ageement. The lease provides that:[46]

> The lessee shall comply with the provisions of the Mines and Minerals Act and any Act passed in substitution therefor, and any regulations that at any time may be made under the authority of the said Acts . . . Each and every provision or regulation hereafter made shall be deemed to be incorporated into this lease and shall bind the lessee as and from the date it comes into force . . .

By retaining the right to alter the terms and conditions of the lease by future unilateral action, the province has the power to draft future conditions to the lease and force the lessee's compliance with those conditions as if they were part of the original agreement made under the authority of s.92(5).

An example of such a condition is s.170.2 of the Mines and Minerals Act which requires the Crown's lessee to deliver the "lessee's share" of production to the Alberta Petroleum Marketing Commission. This compulsion to deliver is a clear case of regulation in the post-extraction stage of production when the Crown's powers under s.92(5) are actually extinguished. The province enacted s.170.2 and rewrote all the outstanding lease agreements, making delivery to the A.P.M.C. a condition of the original conveyance, and apparently valid regulation under the powers of 'management and sale'.

This technique of legislation through contract utilizes the province's strongest constitutional position under s.92(5) by making various regulatory provisions conditions of the original Crown lease. The legitimacy of this technique has not been directly challenged in the courts, although its use dates back to the 1930's. Certainly the line of cases culminating in the *Huggard Assets* decision[47] suggests that Canadian courts may recognize as binding by force of contract a clause in an oil lease which subjects the terms of the lease to any changes subsequently made by statute or regulation.[48] In the *Huggard Assets* judgment, the Privy Council held that a clause reserving to the Crown "such royalty upon the said petroleum and natural gas, if any, from time to time prescribed by regulations of our Governor in Council" authorized the province to vary royalites by regulation after the date of the grant. It may be inferred from the dicta of Mr. Justice Duff in the *Spooner Oils* decision, (a case which involved a gas conservation scheme) that, providing that the right to make future amendments to the lease was specified in clear and explicit language, such changes made by the Crown could become part of the lease as contractual

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46. Reproduced in Crommelin, *supra* n. 44 at 153.

47. *Huggard Assets Ltd.* v. *A.-G. Alta.*, [1953] A.C. 420.

48. This is the conclusion of A. R. Thompson, *"Sovereignty and Natural Resources: A Study of Canadian Petroleum Legislation"* (1969) 4 *U.B.C.L. Rev.* 161, at 183.

obligations.[49] These cases suggest that the clause in the standard Crown lease reserving to the province the right to introduce changes to the lease by statute or regulation is binding on the lessee. But is the province's power to unilaterally amend without limit? Perhaps it is not, as a number of arguments can be made in defence of at least some of the basic provisions of the lease.[50]

First, there are fundamental considerations of contract law. No doubt the lessee's covenant to be bound by terms set from time to time by the Crown can be defended under the principles of freedom of contract; however, the open-ended nature of the Crown lease pushes those principles to their limit.[51] Thus it might be argued that the province is under some duty of 'good faith' in making changes to its outstanding leases. This admittedly vague concept might allow the courts, while recognizing the validity of the amendment provision, to limit the scope of any changes to the lease to those reasonably within the comtemplation of the parties. Similarly, it has been suggested that the courts could find a "core of the contract" comprised of certain fundamental terms which could not be altered by the province, notwithstanding the provision binding the lessee to changes made by statute or regulation. Such fundamentals might include the duration of the term, the right of renewal, the rental and royalty clauses, and the basic rights to produce and to market the petroleum recovered.[52] The difficulty with these arguments is that they are most persuasive in private commercial settings where the party seeking relief has been disadvantaged by an unequal or unfair bargaining position. It is unlikely that the large oil producers, who for years have transacted their business knowing the terms of the standard lease, could assert these arguments against the Crown.[53]

The second argument is a reiteration of the principle established in the *Spooner Oils* decision, that a clause reserving to the province the right to change the terms of the lease from time to time must be specified in the clearest and most explicit terms. It might be argued that this requirement is satisfied only if the clause makes some reference to the particular item or area of the agreement which may be subject to change. For example, the clause specifying that royalties may be varied from time to time by regulation clearly identifies royalties as the variable term of the contract; the prospect of changing royalty rates is specifically within the contemplation of the parties at the time of the grant. But is the clause specifying that "Each and

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49. *Spooner Oils Ltd.* v. *Turner Valley Gas Conservation Board* [1933] 4 D.L.R. 545, at 556: ". . . if it had been intended to incorporate, as one of the terms of the lease, a stipulation that all future regulations touching the working of the property should become part of the lease as contractual obligations, that intention would have to be expressed, not inferentially, but in plain language."

50. This discussion in part follows Thompson, *supra* n. 48 at 185-8.

51. As Thompson observes, to defend the lease under the principles of freedom of contract extends those principles "to such extreme that the consensual nature of contract becomes a mockery." *Id.* at 186.

52. This theory of the "core of the contract", made up of certain fundamental and unalterable terms was developed by Thompson by analogy to a doctrine found in commercial cases. *Id.* at 187.

53. Perhaps the argument could be raised if the province's revisions to the lease were unacceptably drastic.

every provision or regulation hereafter made (under the Mines and Minerals Act) shall be deemed to be incorporated into this lease" sufficiently clear and explicit that the parties would contemplate a transfer from the lessee to the lessor of the right to market the lessee's share of production?[54] Arguably, it is not. The point here is that, depending on the particular provision, it is open to the courts to find the wording of the standard compliance with laws clause too general to meet the requirements of clarity and explicitness.

The third argument is based upon an interpretation of the standard lease as an instrument of conveyance. The provision reserving to the province the right to make unilateral changes is a part of the covenants and conditions of the lease and therefore separate from the conveying portions (the grant, habendum, and reddendum clauses).[55] It might be argued that the benefits conveyed in the grant are entrenched provisions and cannot be varied by the compliance with laws provision which deals only with the subject matter contained in the convenants and conditions.[56] Thus the effect of the clause requiring compliance with future amendments is simply to warn the lessee that the lease is subject to future retroactive regulations or legislative changes. The binding force of these changes would be derived from their status as legislation[57] and not by reason of the provision in the lease, "which would merely serve as notice to the lessee that his rights are no different from those of any other contracting party who runs the risk under Canadian law of having his rights adversely affected by retroactive legislation".[58] The new provisions added to the existing leases are confiscatory, in as much as they may alter benefits or rights granted originally to the lessee: while they might purport to be binding as terms of the original conveyance, they more probably derive their binding force from their legislative character.

A finding by the courts that particular provisions were binding on the lessee *ex lege*, and not *ex contractu*, would not in itself relieve the lessee of his duty of compliance. This would be true even if the provisions added retroactively to the leases actually expropriated a right or interest conferred in the grant.[59] However, if the obligations were found to arise outside of the original conveyance, they may be subject to constitutional challenge as being outside the powers of s.92(5). Depending on the particular provision, it could be argued that the province is no longer attempting to regulate the granting of proprietary rights and interests, but is in fact regulating the various rights

54. The province became the lessee's exclusive marketing agent by adding s. 170.2 to the Mines & Minerals Act, S.A. 1973, c. 94.

55. Thompson *supra* n. 48 at 185.

56. *Id.* As Thompson observes, this approach violates the rule that the instrument is to be read as a whole and that a grant by the Crown is to be construed most strongly against the grantee.

57. *Id.* To impose changes to the lease, the enacting legislation must specify that the new provisions are binding retroactively.

58. *Id.* at 182, In Canadian constitutional law, the will of the legislature can override acquired rights.

59. Deprivation of property without compensation is within provincial legislative competence: *Florence Mining Co. Ltd.* v. *Cobalt Lake Mining Co.* (1908), 18 O.L.R. 274; *aff'd* (1918), 43 O.L.R. 474. However, this power must be exercised in relation to a constitutionally valid purpose. Hogg. *supra* n. 5 at 396.

granted once they are in the hands of the grantee. It is an open question whether regulation of this kind over the production and marketing of an internationally traded commodity is still within the limits of s.92(5).

The province would argue that benefits and rights originally granted under the powers of s.92(5) can later be altered or confiscated under the same head. In other words, s.92(5) empowers the province to attach retroactive conditions to the lease even if those conditions in fact arise *ex lege*. In response it could be argued that s.92(5) expressly limits provincial power to management and sale of public lands[60] and is silent as to what, if any, powers remain once a proprietary interest, even if only a leasehold, has been granted and the Crown's title to that particular interest is extinguished. Depending on the particular provisions, it may be open to the courts to find that retroactive changes to the existing leases are a means to regulate the lessee's various rights. The courts might choose to assess the true purpose of the retroactive provisions and decide that the provincial power to alter *ex lege* the rights conferred in the original conveyance must be limited to matters otherwise within provincial legislative competence.[61]

The arguments available to the lessee to resist unilateral changes to the leases by the province are admittedly tenuous; they would be considered by the lessee only as a last resort in any confrontation with the government. The question of challenging unilateral changes to the lease agreements is strictly a political one, as the lessor-lessee relationship must continue no matter how a dispute over a particular series of leases is resolved. It is this factor perhaps more than any other that anchors the province's power to set unilateral amendments.

III. S. 92(5) IN THE CONTEXT OF ALBERTA'S PETROLEUM LEGISLATION

In the balance of the paper, the provincial powers under s.92(5) will be considered in the context of a number of major pieces of Alberta's petroleum legislation.

A. *Production Regulation*

The rate of oil production in Alberta is regulated by the province under the authority of the Oil and Gas Conservation Act.[62] In form the statute is a prohibition against waste,[63] and designed to maximize total yields from oil reservoirs in the sense of minimizing losses of recoverable oil. This reduction of 'waste' is an important aspect of competent resource management and there is no doubt that conservation legislation *per se* comes within provincial legislative competence. The Supreme Court made this point clear in a 1933 decision,[64] ruling

60. As discussed earlier, the limits of this power are undefined.

61. This argument suggests that even if the courts interpret s. 92(5) as giving the province broad powers to set the original lease provisions, its power under the constitution to retroactively alter leasehold rights *ex lege* may be more limited.

62. R.S.A. 1970, c. 267, as amended by the Energy Resources Conservation Act, S.A. 1971, c. 30.

63. *id.* ss. 5 and 138(1).

64. *Spooner Oils Ltd.* v. *Turner Valley Conservation Board*, [1933] S.C.R. 629.

that a provincial statute created to prevent wastage of natural gas was intended for a provincial purpose and therefore was valid under s.92(13), 'property and civil rights'. Conservation or resource management legislation would undoubtedly be held valid under s.92(5) as well. As discussed earlier, the Crown retains its interest in oil *in situ* under the standard lease agreement. It follows that legislation allowing the province to regulate rates of extraction are within provincial competence under s.92(5) because the province is managing its own property.[65]

The difficulty with the Oil and Gas Conservation Act is that while in form it purports to be conservation legislation, in substance it actually sponsers a cartel of oil producers. Under its pro-rationing scheme[66] oil production in Alberta is subject to a quota system. Broadly speaking, the total monthly demand for oil is calculated and distributed among the province's producing wells. Once a well has reached its quota, it is shut down.[67] The net result of the pro-rationing scheme, at least in theory, is that it tends to put upward pressure on the price of oil. Because the scheme might influence the price of a commodity which is primarily an export good, one could argue that the scheme was aimed at regulating extra-provincial trade and therefore invalid under the federal trade and commerce power.

In response it may be suggested that the realities of the world oil market negate such an argument. The price of oil is no longer determined by supply and other market forces, but is set and pegged artificially by governments responding to changes in the world price.[68] Because the market price of oil in Canada is inflexible, changing production volumes in Alberta will not influence that price. Thus one might suggest that today the pro-rationing scheme sponsors an ineffective cartel; so long as prices are inflexible, the effect and substance of the pro-rationing scheme is, almost by default, strictly conservation and therefore clearly within provincial competence.

Yet the recent CIGOL decision suggest that inflexible consumer prices may be an inconsequential consideration. In rejecting the argument that taxes levied against producers and traders of certain fixed-price commodities are direct taxes, the courts have reasoned that inflexible prices do not figure in the determination of the general tendency of a tax.[69] If the courts choose to apply the same reasoning in an examination of the pro-rationing scheme, it may be decided that the scheme, by regulating the supply of an export goods, is infringing on the federal trade and commerce power, notwithstanding that the regulation of supply will not influence price.

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65. Note that the lessor can only fetter the rate at which the lessee may recover oil by reserving that right in the contract. Section 21(1) of the Oil & Gas Conservation Act, *supra* n. 62 reserves the right to the province.

66. *Id.* s. 34(1).

67. J. B. Ballem, *"The Continuing Adventures of the Oil & Gas Lease"* (1972) 50 *Can Bar Rev.* 423, at 428.

68. The pricing of domestic oil is discussed later in the paper.

69. CIGOL, *supra* n. 2; *A.-G. Man.* v. *A.-G. Can.*, [1925] A.C. 561. This finding is discussed later in the paper.

B. *Petroleum Marketing*

The marketing scheme for oil produced in Alberta is set by the Petroleum Marketing Act.[70] The first portion of the Act creates the Alberta Petroleum Marketing Commission and empowers it to set prices, to sell and to set the terms of sale of all petroleum produced from Crown lands.[71] The Act draws a distinction between the lessee's share of oil produced, and the Crown royalty share. The oil producer is compelled to deliver the Crown royalty in kind to the A.P.M.C.[72] and Part Two of the Act governs the sale of that royalty oil. The producer must also deliver the lessee's share to the A.P.M.C.,[73] and Part Three of the Act names the A.P.M.C. the lessee's exclusive agent in oil sales.[74] These portions of the Act permit the province to regulate the sales of the total volume of oil produced from Crown leaseholds. Part Four of the Act empowers the A.P.M.C. to regulate sales of production from freehold interest, but recognizing that such powers are beyond the scope of s.92(5), the province has not proclaimed Part Four.[75]

The province may be within its legislative authority to create a commission which receives royalties delivered in kind and later sells those royalties. The Crown's royalty share is recovered by the lessee for the province as consideration for the Crown lease. Thus, even before it takes delivery, the province has an equitable interest in the royalty share arising out of contract. Because the royalty is in kind, the province also retains its original proprietary interest in the royalty share. It should be noted that, once extracted, the province's royalty share may no longer be within the limits of s.92(5); since the royalty share is distinct from the land, the A.P.M.C. is in fact regulating the sale of chattels and not the management and sale of public lands. Those chattels move into extra-provincial trade, and it is an interesting issue whether the A.P.M.C.'s regulatory powers over the province's own royalty share may be open to constitutional challenge.

An even more intriguing issue concerns the lessee's share of production. By what authority does the province compel delivery, even if only on paper, to the A.P.M.C. of the lessee's share and then make the A.P.M.C. the exclusive agent of the lessee? It is certainly not under the powers of s.92(5), because the Crown's proprietary interest is extinguished. The province would argue that it attached conditions to the original lease naming the A.P.M.C. exclusive agent and compelling delivery. But these conditions were added under the province's power to unilaterally amend the Crown leases. It might be argued that they are provisions which are confiscatory and which arise *ex lege*, and that they directly affect a fundamental right granted to

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70. S.A. 1973, c. 96.

71. *Id.* s. 13.

72. Mines & Minerals Amendment Act (1973), S.A. 1973, c. 94, ss. 31(4) and 170.1.

73. *Id.* s. 170.2.

74. The Petroleum Marketing Act, *supra* n. 70, s. 21.

75. The province thus does not regulate marketing of freehold production; but because it controls over 80% of the available production resources, the province feels that freehold prices cannot vary too greatly from the prevailing market prices set by the A.P.M.C.

the lessee to market the non-royalty share of production.[76] Furthermore, it may be argued that these provisions are simply a means to an end, that being the regulation of the oil producer in the post-extraction process. Regulation at that stage is beyond the powers comtemplated in s.92(5), and therefore beyond the competence of the province, notwithstanding that the provisions purport to be binding as terms of the lease. These arguments were discussed earlier in some detail; they suggest that Alberta has little authority under s.92(5) to operate a marketing scheme over the lessee's share of production.

If the provincial powers under s.92(5) are so dubious, how then can the province regulate, unchallenged, the marketing scheme of a commodity which is primarily destined for export markets? The answer is that federal involvement undoubtedly makes the whole scheme legitimate. The question of extra-provincial marketing regulation was dealt with by the Supreme Court in the *P.E.I. Potato Marketing Board* v. *Willis* case.[77] There the court held that a provincial products marketing scheme reaching beyond provincial boundaries would in itself be invalid, but that the federal government could delegate power to a provincial marketing board to regulate extra-provincial trade. In other words, provincial regulation of a largely exported commodity is an infringement of the federal trade and commerce power, but a provincial marketing board to which Parliament has delegated its regulatory powers can in fact market and price that commodity.[78] The *P.E.I. Potato* case is important to the study of the Alberta marketing legislation because it suggests that federal involvement may bring an otherwise invalid marketing scheme within provincial competence.

To understand the nature and extent of federal involvement with the A.P.M.C., it is first important to note that, while in form the province has created a marketing scheme, in substance the legislation creates a price setting scheme. There is no collective pooling of products and profits, and subsequent distribution of returns which characterize standard marketing schemes. In fact, the delivery of royalty and lessee shares of production to the A.P.M.C. is strictly a paper transaction. In practice, a field operator "receives" the crown and lessee production shares and "sells" them at A.P.M.C. prices to the same producer by simply completing the necessary forms. The lessee receives a cheque from the A.P.M.C. later in the month which represents the proceeds of the lessee's share.[79] Thus the purpose of inserting the A.P.M.C. as "middle man" into the sales transaction at the wellhead is simply to regulate prices.

If the province were regulating prices on its own, the scheme would clearly be an invalid infringement of the 'trade and commerce' power. However, the prices of various grades of oil are set by the A.P.M.C. according to an agreement between the province and the federal

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76. This argument was discussed in more detail in the portion of the paper dealing with the province's power to unilaterally amend the leases.

77. [1952] 2 S.C.R. 392.

78. *See* Hogg *supra* n. 5 on administrative inter-delegation.

79. For a more detailed description of this process *see* Tyerman, *supra* n. 1 at 439-41.

government.[80] This agreement is not a formal legislative delegation of the federal regulatory powers in the sense comtemplated in the *P.E.I. Potato* case. In so far as its form is lacking, it may be open to attack.[81] But there is no doubt that in substance the agreement represents a marked federal involvement in the price-setting process of the A.P.M.C., and for the moment, the regulation of prices is the commission's single function. In short, federal involvement lends an element of constitutional validity to Alberta's marketing (that is, pricing) legislation. There is every possibility that without this federal involvement the scheme would be challenged and struck down. Or, if the province expanded the regulatory activities of the A.P.M.C. beyond price-setting, these expanded powers might also be struck down.

C. *The Crown Royalty*

Under s.109 of the B.N.A. Act, the provinces have undisputed authority to take royalties in respect of Crown land, and, since 1930, the province of Alberta has enjoyed the same right. Royalties represent an interesting and unique portion of provincial income because they are, in a sense, the only indirect taxes which a province has authority to levy.[82] This is because the provincial power to take royalties stems from the lessor-lessee relationship and not from the taxing authority-taxpayer relationship. The provinces thus rely on the royalty levy as the principle means of raising revenues from resource industries. But in framing their leases and regulations, the provincial governments must take care that the royalty levy is at all times in substance a "genuine" royalty. If the so-called royalty could, in the circumstances, be more properly characterized as a tax,[83] then it could be susceptible to constitutional challenge.

This type of challenge proved successful in the recent *CIGOL* case. In 1973, as part of a larger legislative package, the government of Saskatchewan amended its Petroleum and Natural Gas Regulations (1969)[84] and imposed a "royalty surcharge" on the holders of Crown leases. The "royalty surcharge" was calculated as 100% of the difference between the price received for oil at the well-head and a "basic well-head price" which was set out in the regulations and represented a statutory aproximation of the price per barrel received by producers prior to the 1973 energy crisis.[85] The effect of this surcharge was to divert to provincial coffers the total increase in value of the lessees' share of production after January 1, 1974. Before the

80. The method of arriving at oil prices is discussed *id.* at 436.

81. Section 22 of the Petroleum Administration Act, S.C. 1975, c. 47 authorizes the federal minister to enter into an agreement with Alberta for the purpose of setting mutually acceptable prices; the status of these agreements has not been considered by the courts.

82. Under ss. 92(2) and 91(3) of the B.N.A. Act.

83. A royalty is a share of production reserved to the lessor as a consideration for granting the lease. *B. & B. Royalties Ltd.* v. *M.N.R.*, [1940] 4 D.L.R. 369. In contrast, a tax is a compulsory contribution, imposed by the sovereign for public purposes or objects. *Lawson* v. *Interior Fruit & Vegetable Committee*, [1931] 2 D.L.R. 193. This distinction is discussed by Dickson J. in CIGOL, *supra* n. 2 at 482.

84. Sask. Reg. 8/69, amended by O.C. 410/73 and O.C. 95/74. *See* CIGOL, *supra* n. 2 at 454-5.

85. CIGOL, *id* at 466.

Supreme Court the government argued that the provisions of standard Crown leases reserving to the province the right to set variable royalties expressly contemplated the imposition of the "royalty surcharge". The majority of the court rejected this argument.[86] The majority held that the "royalty surcharge" was not a genuine royalty made in accordance with the Crown lease agreements, but was more properly characterized as a tax upon the lessee's share of production. The court concluded that such a tax was indirect and *ultra vires* the province.[87]

This decision sheds some light on the question of whether the variable royalty provision found in the standard Crown leases gives the province an unlimited discretion to set binding royalties.[88] The government of Saskatchewan had attempted to impose a new royalty obligation on the Crown lessee, but the majority of the Supreme Court ruled that "the 'royalty surcharge' made applicable to these Crown leases was not a royalty for which provision was made in the lease agreement",[89] notwithstanding the lease's broadly worded variable royalty provision. The court interpreted the "royalty surcharge" not as a direct upward variation of the existing royalty but rather as a second or additional levy that arose not as contractual obligation but as tax imposed by the legislature.[90] This approach suggests that a province cannot randomly impose new levies by disguising them as royalties and introducing them as terms of the lease. It can be argued that certain "royalties" added to existing leases might be beyond the contemplation of the parties and not binding as contractual obligations, although the *CIGOL* decision is admittedly unclear as to what factors determine whether a royalty is genuine or not, and whether it arises out of contract or not. In the *CIGOL* case the "royalty surcharge" was a 100% levy, and was held to be a tax and not a genuine royalty because it was inconsistent with the customary view that a royalty represents a "share" of production.[91] It may also be inferred that the "royalty surcharge" was not a genuine royalty because it was superimposed over the existing royalties provided for in the lease. Whatever factors prompted its decision, the important point is that the Supreme Court rejected the argument that the "royalty surcharge" was binding as a contractual obligation; the variable royalty provision of the Crown lease cannot be used to impose, as terms of the lease, levies which are in fact taxes.

At about the same time that Saskatchewan introduced its "royalty surcharge", the province of Alberta was also moving to recover a larger share of the returns generated from oil production. Standard Crown leases in Alberta allowed the province to take a variable

86. *Id.* per Martland J. at 459.

87. *Id.* This finding is discussed more thoroughly *infra*.

88. The validity of the variable royalty was affirmed in *A.-G. Alta.* v. *Huggard Assets Ltd.*, [1953] A.C. 420. The issue here is whether the Crown's power to set royalties is unlimited.

89. CIGOL, *supra* n. 2 at 459. Note that Mr. Justice Dickson apparently reaches the opposite conclusion in his dissenting judgement at 482-4.

90. *Id.* The "royalty surcharge" was levied against the lessee's share of production after the original Crown royalty had been deducted from the total oil produced.

91. *Id. Quaere* whether 80% or 60% royalties are inconsistent with the customary view of the term "share". Did the court mean a "fair share"?

royalty up to a ceiling of 16.6% of production. The ceiling was included in the lease agreements under the provisions of s.143 of the Mines and Minerals Act which read as follows:

> The maximum royalty payable on the petroleum . . . shall not exceed one-sixth of the production obtained from the location.

Wishing to implement a new royalty scheme exceeding this ceiling, the government in 1972 offered lease holders a tax incentive to renegotiate their leases. Few lessees chose to do so, and in 1973 the impatient government enacted s.142.1 of the Mines and Minerals Act declaring all maximum royalty provisions to be void. It then implemented the new royalty scheme which has boosted royalties substantially higher than 16.6%. The issue is whether these new levies are, in whole or in part, still genuine royalties.

The province would argue that the new schedule of royalties is binding on the lessee and that the levies exacted are in total genuine royalties. The province's position is that the lessee contracted to pay royalties which could be varied from time to time by the Crown. The province's right in respect of Crown lands to set such variable royalties was considered and affirmed in the *Huggard Assets* decision.[92] Thus it could be argued that Alberta has done nothing more than vary the existing royalty, and in doing so, has acted in compliance with the terms of the lease agreement and the case law.

This line of argument, while persuasive, is not airtight. It must be remembered that the lease agreement, and the legislation under which it was made, expressly provided for a maximum royalty ceiling. Reading the agreement as a whole, it is entirely possible that a court might interpret the conflicting 'variable royalty' and 'royalty ceiling' provisions as contemplating a changing royalty limited by the 16.6% maximum ceiling. In other words, the province's right to vary the Crown royalty, in so far as that right is reserved in the lease, may be limited by the provision guaranteeing the royalty ceiling.

If this interpretation is valid, it may be argued that, by eliminating the royalty ceiling, s.142.1 of the Mines and Minerals Act is confiscatory;[93] it alters retroactively a right which the lessee acquired at the time of the grant. As discussed earlier,[94] the provincial legislature has certain powers to legislate over and thereby alter acquired contractual rights. However, new obligations imposed by retroactive amendment to the existing lease may in particular circumstances derive their binding force *ex lege* and not *ex contractu*. Thus it might be reasoned that regulations made subsequent to the enactment of s.142.1, to the extent that they exact a royalty in excess of the ceiling contemplated in the lease agreement, are binding not as contractual obligations but rather because of their legislative origin and character.

The province would assert that the new royalty is still binding because of the province's general powers to take royalties from lessees of Crown lands, even if s.142.1 is confiscatory, and subsequent regulations exact levies which are in part beyond the contemplation

92. *Supra* n. 88.

93. Thompson, *supra* n. 48 at 186.

94. *See* the discussion respecting the province's power to make unilateral amendments in the text between notes 53 and 61, *supra*.

of the original lease. In other words, Alberta could argue that it is well within its legislative competence to set new, binding royalties by retroactive changes to the lease agreements, even if those changes are outside the terms of the original lease. But are such royalties still "genuine royalties"? This becomes the crucial question, as the Supreme Court has indicated in its *CIGOL* decision that only a "genuine royalty" is binding *ex contractu*. The province would argue that, although made retroactively and not contemplated in the original lease, the royalties in excess of 16.6% still originate from the lessor-lessee relationship. They are binding as "genuine royalties", if not as contractual obligations, because the province in its dual role as legistor and proprietor has so decreed. But the lessee may counter this line of reasoning, by arguing that a "genuine royalty", even a variable royalty, requires a consensual agreement and mutuality. The old agreements provided for a maximum ceiling, and the new levies are in excess of that ceiling; they no longer originate from a mutual agreement of the parties, at least to the extent that they exceed the 16.6% limit.[95] Further, because it originates with a confiscatory piece of legislation, the royalty in excess of the 16.6% ceiling is perhaps in substance more of a levy upon the lessee's share of production granted in the original lease than a "genuine royalty". Thus it could be argued that the Crown royalty in excess of 16.6% is a compulsory levy imposed by the province acting *qua* taxing authority. That such a levy might be a tax is not fatal; it must, however, withstand constitutional scrutiny as to whether it is indirect and hence *ultra vires* the province.

Until the CIGOL case, the question of whether levies are direct or indirect would have been a difficult problem. The standard definition is that of J.S. Mill: if the general tendency of the tax is that persons on whom it is levied will try to recover it in a price charged to others, then the tax is indirect.[96] In the CIGOL case, the Saskatchewan Court of Appeal accepted the argument that the provincial levies were not indirect taxes because with the price of oil artificially frozen the producers could not attempt to recover the tax from others.[97] But the majority of the Supreme Court rejected this argument. The court ruled that the fact that the price of oil could not be changed did not alter the general tendency of the tax, which was levied on producers but ultimately paid by consumers. The government's tax policy has simply made the producer "a conduit through which the increased value (of production) is channelled into the hands of the Crown by way of tax".[98] Hence, the tax levied on a producer of a commodity or product, the price of which is artificially set or frozen, is still an indirect tax and *ultra vires*

95. As mentioned earlier, this argument is premised on the view that the courts will interpret the conflicting 'variable royalty' and 'royalty ceiling' provisions as contemplating a changing royalty up to the 16.6% ceiling. In other words, the parties did not agree, as contractual obligations, that the province should have unlimited power to set new royalties.

96. *Bank of Toronto* v. *Lambe* (1887), 12 A.C. 575; *A.-G. B.C.* v. *Kingcome Navigation Co. Ltd.*, [1934] A.C. 51.

97. [1976] 2 W.W.R. 356.

98. CIGOL, *supra* n. 2 at 462.

the province.[99] This finding suggests that if the Alberta royalties in excess of 16.6% were found to be taxes and not genuine royalties, that they would also be ruled *ultra vires* the province.

In short, after the *CIGOL* decision, the status of Alberta's royalty laws is precarious. If the courts can be persuaded that s.142.1 of the Mines and Minerals Act is confiscatory, and the the royalties now being paid in Alberta exceed those contemplated in the old lease agreements, the provincial royalties in excess of 16.6% may be undone as indirect taxes. The Crown lessees have not challenged the new royalty schedule, considering that their leases are only for ten year periods and that good relations with the provincial government are essential to running a smoothly operating, ongoing business. The lessees have chosen to live with higher royalties; concilliation here pays greater long run dividends than confrontation.

IV. FEDERAL JURISDICTION OVER OIL

Both levels of government exercise control over different stages of the oil sector between untapped pools and the final consumer. Provincial powers are concentrated at the production end of the process; under s.92(5) the province has the exclusive power to regulate the production process at least until the time of extraction. As provincial authority is expanded beyond the production and recovery stages it becomes increasingly suspect.

On the other hand, federal policy has been principally focused on the consumption and trade aspects of the oil industry. The Petroleum Administration Act[100] provides for a national petroleum marketing scheme designed to give Canada uniform prices in oil. The Act empowers the federal government to levy a tax on oil exports from Western Canada,[101] and the revenues generated by that tax are used to offset the higher prices paid in Eastern Canada to world suppliers. The necessary interference with trade and commerce which such a system entails, including the regulation of intra-provincial regulations, has been held within federal legislative competence.[102] Should the federal government choose to further expand its regulation of the petroleum sector, what would be the limit of its legislative reach, particularly in relation to the production and recovery stages?

There are a number of considerations. It is conceivable that the federal government could follow in the wake of the Supreme Court's expansion of the 'trade and commerce' power and, arguing that oil is a highly mobile trade commodity, extend its control and regulation of the oil sector back to the wellhead. This is the approach used in natural gas pricing in the United States,[103] but it is unlikely that even the broadest reading of the 'trade and commerce' power would permit the marked diminution of provincial powers which such an expanded federal role would involve.

Under the 'peace, order and good government' clause of s.91,

99. This result is consistent with an earlier decision in the *Grain Futures* case, *A.-G. Man.* v. *A.-G. Can.*, [1925] A.C. 561.

100. S.C. 1975-76, c. 47.

101. *Id.* s. 7.

102. *Caloil Inc.* v. *A.-G. Can.*, [1971] S.C.R. 543.

103. Crommelin, *supra* n. 6 at 142.

Parliament does have a power to legislate over matters that have an important 'national dimension'. This power is widely accepted as the basis for exclusive federal jurisdiction over another energy source, atomic energy, and over mining and trade in uranium;[104] similarly, this power was held to support federal legislation concerning offshore minerals.[105] But, apart from a critical national emergency, it is highly unlikely that the courts would allow the expansion of the general powers in matters clearly within s.92. Though energy conservation is a problem of 'national dimension', unless there were critical national shortages, the provincial powers of 'management and sale' over petroleum resources would withstand federal initiatives to regulate production made under the general power.

Finally, it has been suggested that the federal government could unilaterally assume greater, if not total, control of the petroleum sector under its powers in s.91(29). That section places the class of subjects defined by s.92(10)(a) and (c) within the exclusive authority of Parliament, so that they are construed as if they were specially enumerated in s.91.[106] Under s.92(10)(a), the federal government has the authority to regulate pipeline transportation of oil, a power which in theory could be exploited to dominate the entire industry. But more importantly, under s.92(10)(c) the Dominion could declare the well, pipelines, refineries and processing plants of the oil industry to be 'works' for the general advantage of Canada, and then make laws in relation to the entire industry. This legislative technique has been endorsed by the Supreme Court,[107] although there is some question as to what the term 'works' includes. Nonetheless if Parliament can declare grain elevators 'works' for the general advantage of Canada, and subsequently assume control of wheat trade, then the declaratory power of s.92(10)(c), used in conjunction with the trade and commerce and national dimension arguments, could open the entire petroleum industry to federal regulation.[108]

It is evident from this brief discussion that Alberta's control over its oil industry may be vulnerable to future federal initiatives. The scope of provincial authority under s.92(5) is perhaps not as broad as has been suggested in Edmonton. It may be argued that the true constitutional value of s.92(5) is that it stands as a shield by which the province could resist an enlargement of the federal role in regulation of the petroleum sector.[109] Whether s.92(5) would withstand a federal declaration made under s.92(10)(c) is an open issue. It is clear that because of the extra-provincial character of the oil industry, the scope for increased federal involvement is considerable. Alberta has strained the limits of its legislative competence, and undoubtedly future changes in the locus of legislative power over oil will originate in Ottawa.

104. D. Gibson, *"Constitutional Jurisdiction Over Environmental Management in Canada"* (1973) 23 *U.T.L.J.* 54, at 63.

105. *Re Ownership to Off-Shore Minerals Rights*, [1967] S.C.R. 792.

106. Crommelin, *supra* n. 6 at 111; *Montreal* v. *Montreal Street Railway*, [1912] A.C. 333.

107. *The King* v. *Eastern Terminal Elevator Co.*, [1925] S.C.R. 434.

108. J. B. Ballem, *"Constitutional Validity of Provincial Oil & Gas Legislation"* (1963) 41 *Can. Bar Rev.* 199, at 230-1.

109. In a political showdown Alberta could of course refuse to sell or lease its holdings *in situ;* this power, guaranteed by s. 92(5), is Alberta's constitutional ace.