CONFIDENTIALITY AND DISPOSITIONS IN THE OIL AND GAS INDUSTRY

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The author examines issues relating to confidentiality and dispositions in the oil and gas industry. He surveys the general common law and equitable principles concerning breach of fiduciary duty and breach of confidence as they relate to the oil and gas industry as well as contractual obligations to joint working interest owners. The author presents an in-depth examination of issues in negotiating and drafting confidentiality agreements. There is a discussion of general concerns including what information is considered confidential, when there is a disclosure requirement and what remedies are available for a breach of confidence. The author also looks at possible specific provisions of confidentiality agreements such as covenant trusts, standstill covenants and area of exclusion covenants.

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I. INTRODUCTION

The protection of confidential information is an important component of many transactions in the oil and gas industry and, due to the nature of the industry, there are issues with respect to confidential information that are unique. For example, in the context of dispositions, a disposing party may desire to provide sensitive seismic and well reservoir information for the review of interested purchasers for the purpose of entering into a purchase and sale transaction but, as a result of other contractual

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arrangements, the disposing party may be subject to restrictions on its ability to make disclosure of that information.

Depending on the size and nature of the disposition, there will be varying measures taken to protect information from improper use or disclosure by those interested purchasers. From a practical perspective, the disposing party may limit access to the information by setting up bid or data rooms with strict controls on the nature and extent of information available. From a legal perspective, the disposing party will likely require interested purchasers to enter into confidentiality agreements and, in circumstances where the information to be provided for review is especially sensitive, an area of exclusion or "whitemap" covenant.

This article focuses on four legal aspects relating to the provision and protection of confidential information in the context of oil and gas dispositions, namely:

(1) a brief overview of the common law and equitable principles, especially as they relate to breach of confidence, and how they protect confidential information in the absence of or as a supplement to a confidentiality agreement;

(2) the ability of a confider to disclose to interested purchasers information that is subject to confidentiality obligations in favour of third parties under the 1990 Canadian Association of Petroleum Landmen ("CAPL") Operating Procedure;

(3) the remedy of interim injunctive relief, which is available to prevent the improper use or disclosure of confidential information; and

(4) a discussion of the main considerations in the negotiation and drafting of confidentiality agreements.

II. GENERAL COMMON LAW AND EQUITABLE PRINCIPLES

The confider of confidential information enjoys significant protection at law even in circumstances where a confidentiality agreement has not been entered into between the confider and the confidant of such confidential information. This is important to recognize from the confidant's perspective, because it may review information with the intention of making an acquisition from or of the confider, but may use the information for other purposes or may disclose the information to third parties. Due to the scope and effect of common law and equity, the fact that the confider and confidant have not entered into a confidentiality agreement should not be of significant comfort to the confidant.

In fact, even where a confidentiality agreement does exist, a court may still adopt common law and equitable principles to supplement the agreement.[1] A breach of confidence action may also be made out notwithstanding that the information was obtained via a third party if the recipient is aware that this information is of a confidential nature.[2]

There are three common law and equitable causes of action for improper use or disclosure of confidential information. These causes of action can be founded upon:

(1) breach of an implied term of a contract;

(2) breach of a fiduciary duty; or

(3) breach of a general duty of confidence.

The legal principles regarding breach of fiduciary duty and breach of confidence are discussed below.[3]

A. BREACH OF FIDUCIARY DUTY

Breach of a fiduciary duty is a separate cause of action from that available under either breach of contract or breach of confidence and is based upon an underlying obligation not to disclose information obtained in the course of a fiduciary relationship. Although a fiduciary relationship does not normally arise between arm's-length commercial parties, both LaForest and Wilson JJ. held in *International Corona Resources Ltd.* v. *LAC Minerals Ltd.*[4] that a fiduciary duty could arise with respect to confidential information exchanged.

Wilson J. set out the three general characteristics of a fiduciary obligation in *Frame* v. *Smith*:[5]

(1) the fiduciary has scope for the exercise of some discretion or power;

(2) the fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests; and

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1 *Cadbury Schweppes Inc.* v. *FBI Foods Ltd.*, [1994] 8 W.W.R. 727 (B.C.S.C.) [hereinafter *Cadbury Schweppes*].

2 *A.G.* v. *Guardian Newspapers Ltd. (No. 2)*, [1988] 3 All E.R. 545 (H.L.).

3 An action for a breach of an implied term of a contract is most commonly found in employer-employee relationships. A duty of confidentiality is generally implied in these types of relationships and is an extension of the "duty of good faith or fidelity" owed by an employee to an employer: *Faccenda Chicken Ltd.* v. *Fowler*, [1986] 1 All E.R. 617 at 625 (C.A.). This principle is not discussed in this article.

4 [1989] 2 S.C.R. 574, aff'g (1986), 53 O.R. (2d) 737 (H.C.), (1987), 62 O.R. (2d) 1 (C.A.) [hereinafter *LAC Minerals*].

5 [1987] 2 S.C.R. 99 at 136.

(3) the beneficiary is peculiarly vulnerable to, or at the mercy of the fiduciary holding the discretion or powers.

It is widely thought that the criterion of vulnerability is the most important in establishing a fiduciary relationship. It is perhaps for this reason that Sopinka and McIntyre JJ. in *LAC Minerals* emphasized that a lack of vulnerability lead to finding that no fiduciary duty existed with respect to the confidential information. According to Sopinka J.:

> Clearly, a dependency of this type did not exist here. While it is perhaps possible to have a dependency of this sort between corporations, that cannot be so when, as here, we are dealing with experienced mining promoters who have ready access to geologists, engineers and lawyers ... If Corona [the confider of information] placed itself in a vulnerable position because LAC [the confidant of information] was given confidential information, then this dependency was gratuitously incurred. Nothing prevented Corona from exacting an undertaking from LAC that it would not acquire the Williams property unilaterally.[6]

It was Wilson J.'s view in *LAC Minerals* that the vulnerability arises, not from an inequality of bargaining power, but from the disclosure of the information itself and that, although no ongoing fiduciary relationship existed between the parties, a fiduciary duty did arise with respect to the information exchanged in confidence. This view is subscribed to by John McDougall.[7] However, it is submitted that this view will not prevail in the oil and gas industry and the more restrictive views of Sopinka and McIntyre JJ. will prevail. Considering the sophistication of the parties and the use of relatively standardized documentation in the oil and gas industry (*e.g.* the CAPL Operating Procedure), it is unlikely that actions for improper use or disclosure of confidential information will succeed on the basis of a breach of fiduciary duty.

The restrictive approach of Sopinka and McIntyre JJ. has been adopted by Shannon J. in *Mesa Operating Limited Partnership* v. *Amoco Canada Resources Ltd.*[8] The facts leading up to the dispute are described in the headnote to the case as follows:

> Mesa sold its Canadian oil and gas properties to Dome, reserving a 12.5% overriding royalty. Amoco Canada Resources Ltd. succeeded Dome. Dome had pooled a successful gas well with the north half of the same section, effectively reducing Mesa's royalty to 6.25%. Dome's nonparticipation in certain nonconsent wells placed it in a penalty position, during which time it received no production proceeds and paid no royalties to Mesa. Dome also failed to continue, surrendered, released or abandoned a Crown lease on nonproducing properties. Mesa claimed entitlement to notice and royalties on gross proceeds from the nonproducing lands. Mesa brought an action against Amoco claiming entitlement to royalties that should have been paid.

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6 *Supra* note 4 at 606.

7 J.L. McDougall, "The Relationship of Confidence" in D.W.M. Waters, ed., *Equity, Fiduciaries and Trusts 1993* (Scarborough: Carswell, 1993) at 165-66.

8 (1992), 129 A.R. 177 (Q.B.), aff'd (1994), 149 A.R. 187 (C.A.), leave to appeal to S.C.C. denied (1994), 21 Alta. L.R. (3d) xxxvii [hereinafter *Mesa*].

Shannon J. rejected Mesa's claim that Dome was in a position as its fiduciary. He wrote:

> In the case at bar two commercial companies entered into an arm's length commercial transaction. They were both established oil and gas exploration companies with engineering, legal, geological, and land expertise available to them for decision-making on a daily basis. No inequality of bargaining power existed between the parties.
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> On this issue, therefore, I apply the reasoning of Sopinka, J., in LAC, at pages 595-596:
>
> > "The consequences attendant on a finding of a fiduciary relationship and its breach have resulted in judicial reluctance to do so except where the application of this 'blunt tool of equity' is really necessary. It is rare that it is required in the context of an arm's length commercial transaction."[9]

While this case is not directly on point with respect to the improper use or disclosure of confidential information, it is indicative of the recent trends of the courts with respect to the legal principles related to fiduciary duties in the context of arm's length commercial transactions.[10] As a result, in the absence of an express confidentiality agreement, the most useful legal remedy for improper use or disclosure of confidential information in the oil and gas industry will likely be based upon breach of confidence.

B. BREACH OF CONFIDENCE

The leading Canadian case on the subject of breach of confidence is *LAC Minerals*. In that case, the defendant used confidential information obtained during negotiations toward a joint venture agreement in order to purchase a lucrative gold mining property. Sopinka J. recognized breach of confidence as a distinct cause of action.[11]

In formulating the test for breach of confidence, the Court in *LAC Minerals* relied on the leading English decision of *Coco* v. *A.N. Clark (Engineers) Ltd.*[12] In that case, Megarry J. identified three requirements that must be satisfied in order to establish a cause of action for breach of confidence and that have "been adopted as an accurate statement of the law by virtually every court in the Commonwealth."[13] The three requirements that must be satisfied are:

(1) that the information transferred has the "necessary quality of confidentiality" about it;

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9 *Ibid.* at 215.

10 See also *Luscar Ltd.* v. *Pembina Resources Ltd.* (1994), 24 Alta. L.R. (3d) 305 (C.A.), leave to appeal to S.C.C. denied with costs August 17, 1995 [hereinafter *Luscar*].

11 *Supra* note 4 at 615.

12 [1969] R.P.C. 41 (Ch.D.) [hereinafter *Coco* v. *A.N. Clark*].

13 *Supra* note 7 at 160.

(2) that the circumstances of the transfer are such that the recipient is under an obligation to the confider with respect to the information; and

(3) that the information has been used for a purpose other than that for which it was intended.

1. The Information Must Be Confidential

Under the initial branch of the test, it must be established that there has been an exchange of specific and identified information that meets the test of confidentiality. Although dependent on the circumstances in each case, generally the test will be met by establishing that the information is not readily accessible to others because steps have been taken to protect it.[14]

Further guidance on this point is provided by *Pharand Ski Corp.* v. *Alberta*,[15] which enumerates several factors as a non-exhaustive list of what may render certain information confidential.[16] These factors are succinctly summarized by James Kokonis:

(1) the extent to which the information is known outside the owner's business;

(2) the extent to which it is known by employees and others involved in the owner's business;

(3) the extent of measures taken by [the owner of the information] to guard the secrecy of the information;

(4) the value of the information to [the owner] and [the owner's] competitors;

(5) the amount of money or effort expended by [the owner] in developing the information;

(6) the ease or difficulty with which the information could be properly acquired or duplicated by others [through their own independent endeavours]; and

(7) whether the owner of the information and the party confided in treat the information as being confidential.[17]

John McDougall states that the important reason for identifying the information at issue with some particularity is to enable the court to determine the range of action that the confidant has been permitted to undertake. As a result, the "springboard" or "long start" doctrine has emerged, whereby the court determines whether the information in

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14 *Ibid.* at 161.

15 (1991), 80 Alta. L.R. (2d) 216 (Q.B.) [hereinafter *Pharand*].

16 *Ibid.* at 246-47.

17 J.D. Kokonis, "Confidential Information" in G.F. Henderson, ed., *Copyright Law of Canada* (Scarborough: Carswell, 1994) 325 at 331.

question enabled the defendant to do something it could not otherwise have done, or could not have done as quickly, without the information.[18]

The courts may resort to the "springboard" theory even where the sources of information may be known and available to the public. The leading decision on this point is *Saltman Engineering Co.* v. *Campbell Engineering Co.*,[19] where Lord Greene stated:

> [I]t is perfectly possible to have a confidential document, be it a formula, a plan, a sketch, or something of that kind, which is the result of the work done by the maker on materials which may be available for the use of anybody; *but what makes it confidential is the fact that the maker of the document has used his brain and thus produced a result which can only be produced by somebody who goes through the same process.*[20]

The rationale of this principle is probably best stated by Roxburgh J. in the trial court decision in *Terrapin Ltd.* v. *Builders' Supply Co. (Hayes) Ltd.*:[21]

> The brochures are certainly not equivalent to the publication of the plans, specifications, other technical information and know-how. The dismantling of a unit might enable a person to proceed without plans or specifications, or other technical information, but not, I think, without some of the know-how, and certainly not without taking the trouble to dismantle. I think it is broadly true to say that a member of the public to whom the confidential information had not been imparted would still have to prepare plans and specifications. He would probably have to construct a prototype, and he would certainly have to conduct tests. Therefore, the possessor of the confidential information still has a long start over any member of the public.[22]

These decisions are consistent with the test applied in the United States. The case of *Tlapeck* v. *Chevron Oil Company*[23] involved an action taken by an oil company against its former employee. Becker C.J. found that the former employee used his employer's confidential information in acquiring a lease. The evidence indicated that the former employee, a geologist, developed a unique theory concerning oil development by using confidential information that was available to him through his employment with the oil company. The court held that, while some of the information was available from other sources, much of the information was not and therefore was confidential. Becker C.J. concluded that "information developed as a result of the employer's initiative and investment"[24] constituted confidential information.

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18 *Supra* note 7. See also *Ridgewood Resources Ltd.* v. *Henuset* (1982), 35 A.R. 493 at 500 (C.A.); and *Pharand*, supra note 15.

19 [1963] 3 All E.R 413 (C.A.) [hereinafter *Saltman Engineering Co.*].

20 *Ibid.* at 415 [emphasis added]. This test was approved by, *inter alia*, Sopinka J. in *LAC Minerals*, *supra* note 4 and by the Alberta Court of Appeal in *Walter Stewart Realty Ltd.* v. *Traber*, [1995] A.J. No. 636 (QL).

21 [1967] R.P.C. 375.

22 *Ibid.* at 391-92.

23 407 F.2d 1129 (1969).

24 *Ibid.* at 1135.

More recently, in *Amoco Production Company* v. *Laird*,[25] Amoco sought injunctive relief against a competitor who allegedly used Amoco's trade secrets in order to obtain oil leases. Protection pursuant to Indiana's *Uniform Trade Secrets Act* was sought. Dickson J. of the Supreme Court of Indiana held that information regarding the location of potential oil fields was entitled to trade secret protection because Amoco established that its geographical information was not "readily ascertainable." Evidence indicating that the information was generated only after a lengthy investigation and expenses in excess of $150,000 on microwave radar surveys persuaded Dickson J. to find that the information was confidential.

In *LAC Minerals* much of the Corona property had been previously explored and many of the results had been published. Still, the judgment of the Ontario Court of Appeal, agreeing with the trial judge, held that, of the "total package" of information, some had not been published and therefore it was all confidential.[26]

Overall, what makes the information subject to protection by the courts is the fact that the owner of the information has used his skill, knowledge and efforts to produce a result which the confidant could only obtain independently by investing the same time and effort as that expended by the confider. As such, courts will protect information of this kind, even if only for a limited time period, to prevent another party from relying on it and using it as a "springboard" to obtain an advantage over others and to the detriment of the owner of the information.[27]

2. The Circumstances in which the Information was Communicated

This factor is usually the key element in determining whether a breach of confidence action can be maintained. In *Coco* v. *A.N. Clark*, Megarry J. stated:

> However secret and confidential the information, there can be no binding obligation of confidence if that information is blurted out in public or is communicated in other circumstances which negative any duty of holding it confidential.[28]

According to the textwriters, this second criterion will be satisfied whenever information is communicated for a "limited purpose."[29] According to McDougall, it must be shown that the confidant knew or ought to have known that the information was disclosed for a limited purpose and was not to be used for any purpose except that for which it was entrusted to the recipient.[30] This will of course be a question of fact in each case.

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25 622 N.E.2d 912 at 920 (Ind. 1993).

26 The S.C.C. did not address the subject in any depth, instead concentrating on the second branch of the test. *Supra* note 4.

27 *Supra* note 17 at 330.

28 *Supra* note 12 at 47-8.

29 *Supra* note 7. See also F. Gurry, *Breach of Confidence* (Oxford: Clarendon Press, 1984).

30 McDougall, *ibid.* at 168.

3. Unauthorized Use of the Information

According to LaForest J. in *LAC Minerals*, the question for determination is what the recipient is entitled to do with the information, not what it is prohibited from doing. Therefore, it would seem that any use of the information outside the purpose for which it was intended would not be permissible. Moreover, where the information in question is in part public and in part private, the recipient must take special care to use only the material which is in the public domain.[31]

It is important to note that industry practice, while not conclusive, will be given significant weight in determining what the parties can reasonably expect from one another with respect to the use of any information exchanged.[32] For example, in *Cadbury-Schweppes* the Court took judicial notice of industry practice in the food products industry with respect to confidential information:

> All parties to these proceedings agree that it is the custom in the food industry to recognize product-specific formula and process information as confidential and proprietary. Such information will not be disclosed to others or otherwise used, whether by employees, licensees, consultants or others, without the prior knowledge and consent of the owner. This industry custom operates whether or not an express confidentiality agreement is in place, and applies even to entirely generic products.[33]

There is some question as to whether the use of the information is truly unauthorized if no detriment is suffered by the confider. While several cases have held that detriment is required to establish this branch of the test,[34] another suggests that detriment is not a requirement to establish a cause of action and that it is better treated as a factor which will affect available remedies.[35]

The lack of a requirement that the aggrieved confider suffer detriment can be somewhat disconcerting for the confidant. For example, a company may disclose information about an oil and gas plan to a competitor for the purpose of negotiating a purchase and sale transaction with the competitor. The competitor may then use the information for the purposes of making a bid at a land sale in the area. If the confider does not make a bid, it presumably does not suffer any detriment arising out of the use by the confidant of the confidential information. It would seem unjust to require a confidant to account to the confider for the benefits enjoyed by it in these circumstances.

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31 *Saltman Engineering Co.*, *supra* note 19, as applied in *Pharand*, *supra* note 15.

32 *Thomas Marshall (Exports) Ltd.* v. *Guinle*, [1978] 3 All E.R. 193 at 209-10; *LAC Minerals*, *supra* note 4; and *Cadbury-Schweppes*, *supra* note 1.

33 *Cadbury-Schweppes*, *ibid.* at 738.

34 *LAC Minerals*, *supra* note 4, LaForest J.; *Ontex Resources Ltd.* v. *Metalore Resources Ltd.* (1993), 13 O.R. (3d) 229 (C.A.), leave to appeal denied, [1993] 4 S.C.R. vi; *ICAM Technologies Corp.* v. *EBCO Industries Ltd.*, [1993] B.C.J. No. 2339 (C.A.) (QL); *Colborne Capital Corp.* v. *542775 Alberta Ltd.*, [1995] A.J. No. 538 (Q.B.) (QL).

35 *Pharand*, *supra* note 15. Curiously, the court in this case based this conclusion on the judgments of Sopinka and LaForest JJ. in *LAC Minerals*.

III. CONTRACTUAL OBLIGATIONS TO JOINT WORKING INTEREST OWNERS

A. GENERALLY

With respect to dispositions in the oil and gas industry, it is likely that all or a portion of the applicable assets are not 100 percent owned and, accordingly, are subject to agreements with third parties. Under the terms of many agreements pertaining to joint operations,[36] information pertaining to those assets may be subject to confidentiality obligations to the other parties to the agreements that restrict the ability of a party to make disclosure of that information. This can present a problem for the disposing party, because it may desire to disclose confidential information to interested purchasers in order to enhance the value of the applicable assets.

There is a balance to be struck between the interests of the third parties with those of the disposing party. In most circumstances, there is cooperation among parties allowing for disclosure of confidential information by the disposing party. However, there may from time to time be circumstances in which a third party does not cooperate in permitting such disclosure. The following is an analysis of the 1990 CAPL Operating Procedure and the extent to which a disposing party may unilaterally release confidential information to interested purchasers.

B. CONFIDENTIAL INFORMATION (UNDER THE 1990 CAPL OPERATING PROCEDURE)

Under the 1990 CAPL Operating Procedure, all information obtained by a party pursuant to the operating procedure or the accompanying agreement may be used by that party for its sole benefit. However, a party must take appropriate measures to keep all such information confidential from third persons, subject to a number of exceptions,[37] including information:

(1) that the parties have expressly agreed among themselves to release;

(2) in the public domain;

(3) required to be disclosed pursuant to applicable law;

(4) released to affiliates;

(5) released to a third person to which a party has been permitted to assign a portion of its interest;

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[36] See *e.g.* the CAPL operating procedure, royalty procedure and farmout agreement (incorporates the operating procedure).

[37] The 1981 and earlier CAPL operating procedures do not include exceptions to the confidentiality requirements.

(6) released to technical, financial or other professional consultants providing services to the party or financial institutions for the purposes of obtaining financing; and

(7) released for the purposes of scout check.

In circumstances where a producer desires to sell assets that are subject to the 1990 CAPL Operating Procedure or the shares of a subsidiary that is party to the Operating Procedure, it will be limited by the provisions of clause 1801. This can be a problem for an oil and gas company because it may desire to disclose information that it obtains pursuant to the operating procedure, for example well logs, flow tests and the like, to prospective purchasers for the purposes of enhancing the asking price or bid amount for its assets or shares.

The confidentiality obligation set forth in clause 1801 is very broad. It purports to cover all information that is exchanged by the parties to the operating procedure pursuant to its terms and the agreement into which it is incorporated. Is a clause of this nature enforceable? From a U.S. perspective, Fred E. Ferguson, Jr. writes:

> Perhaps not surprisingly, not every express confidentiality agreement is enforceable. Enforceability seems to vary depending upon the kind of relationship between the parties, the kind of information being dealt with, and the manner in which the party seeking to enforce confidentiality has maintained and imparted the information. A distillation of the cases and commentary leads to the conclusion that confidentiality agreements will be enforceable if they satisfactorily meet a three part test: (1) The situation in which the information is imparted to another must be such as to impose a duty of confidentiality on the recipient. (2) The parties must be dealing with information which is substantial enough to merit protection by a court. (3) The information must be secret and maintained on a confidential basis by the owner or accumulator.[38]

While Ferguson's statements are provided in the context of U.S. law, it has been noted by Frank Erisman and John D. McCarthy that "American and Canadian law differ little on the theory of breach of confidence."[39] Applying Ferguson's test, clause 1801 will, with respect to information "which is substantial enough to merit protection by a court," satisfy each of the three parts. Put succinctly, information that a party desires to disclose for the purpose of enhancing the asking or bid price for its assets or shares is likely information "which is substantial enough to merit protection by a court."

The 1991 CAPL Operating Procedure provides that all information obtained thereunder or pursuant to the agreement into which it is incorporated is confidential. The operating procedure also provides that a party may use such information for its

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[38] F.E. Ferguson, "Confidentiality Agreements in the Mining Industry" (20-22 July 1989) 35 Rocky Mountain Mineral Law Institute: Proceedings of the Thirty-Fifth Annual Institute 7-1 at 7-2 and 7-3.

[39] F. Ensman and J.D. McCarthy, "Obligation Not to Use Confidential Information Disclosed During Negotiations to Acquire Interests in Mineral Properties: Observations on International *Corona Resources Ltd.* v. *Lac Minerals Ltd.*" (16-18 July 1987) 33 Rocky Mountain Mineral Law Institute: Proceedings of the Thirty-Third Annual Institute 23-1 at 23-15.

own benefit. The problem that arises from time to time in the industry is with respect to interpretive reports and other data that are generated internally by a party to the operating procedure but which are based upon confidential information received by that party. The annotated version of the 1990 CAPL Operating Procedure states that the inclusion of the provision whereby a party may use the information for its own benefit is included to eliminate any possible argument of a constructive trust if a party uses joint information to acquire adjacent lands for its own account when there is no express area of mutual interest obligation.[40]

However, it may be argued that this provision permits a party to use confidential information to generate its own interpretive data and to disclose such interpretive data to third parties. Based upon the reasoning set forth in the Ontario Court of Appeal decision in *LAC Minerals*, a contrary argument can be advanced. The Court held that when a package of information is comprised of both non-confidential and confidential information the "total package"[41] is confidential. Accordingly, interpretive data that is comprised of information which is confidential under the terms of the Operating Procedure and a party's own information is itself confidential.

Another line of attack may be based upon the overriding obligation of the parties to an operating procedure to exercise their rights and obligations in good faith.[42] Shannon J. in *Mesa*, in finding that Dome had proceeded in a manner that constituted a breach of an implied term obliging it to act in good faith, wrote:

> There the court enunciated the principle that there was an obligation on parties to a contract to act in good faith and that duty limits the exercise of discretion conferred on parties by an agreement. In that case it was held that the common law duty to perform in good faith is breached when a party acts in bad faith, that is, *when a party acts in a manner that substantially nullifies the contractual objectives or causes significant harm to the other, contrary to the original purposes or expectations of the parties.*[43]

Arguably, if a party to the operating procedure can defeat the provisions of clause 1801 simply by creating its own interpretive data that is based, in whole or in part, on confidential information, that party is acting in a manner that substantially nullifies the contractual objectives, contrary to the original purposes or expectations of the parties.

C. EXCEPTIONS TO CONFIDENTIALITY REQUIREMENTS

In the context of the disclosure of information for the purposes of selling assets or shares, the relevant provisions of clause 1801 are as follows:

> Each party entitled to information *obtained hereunder or pursuant to the Agreement* may use such information for its sole benefit. However, the parties shall take such measures with respect to

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40 Based upon the decision in *Luscar*, *supra* note 10, this is likely the case in any event.

41 *Supra* note 4.

42 See Part III.C, above.

43 *Supra* note 8 at 218 [emphasis added].

operations and internal security as are appropriate in the circumstances to *keep confidential from third persons all such information*, except information which the parties have expressly agreed among themselves to release and information disclosed by a party:

...

(c) to a third person to which such party has been permitted to assign a portion of its interest hereunder, provided that a binding covenant is obtained from such third person prior to disclosure which provides, *inter alia*, that none of such information shall be disclosed by it to any other third person;

...

However, the confidentiality obligation in this Clause shall not extend to information to the extent it is in the public domain, provided that specific items of information shall not be considered to be in the public domain merely because more general information is in the public domain. [emphasis added]

There are three relevant exceptions to the confidentiality requirements set forth in clause 1801 that, in the context of dispositions, a party to the 1990 CAPL Operating Procedure ought to consider, namely:

(1) information the parties agree to release;

(2) information in the public domain; and

(3) information released pursuant to clause 1801(c).

1. Information the Parties Agree to Release

Under this exception to the confidentiality requirements in clause 1801, all of the parties to the Operating Procedure may agree that a party may release confidential information to interested purchasers. However, a party is likely not required to act reasonably when exercising its discretion as to whether it will enter into such an agreement. In *P&G Cleaners Ltd.* v. *Johnson*,[44] Jewers J. considered a clause in an agreement which prohibited a course of conduct by one party unless it was consented to by the second party. The agreement was silent regarding the existence of a duty of the second party to act reasonably in exercising its discretion as to whether to grant its consent. Jewers J. held that:

The right to give or withhold consent is in absolute terms; there are no conditions or provisions attached. It is not like the familiar case of the provision in a lease whereby a landlord's consent to the assignment of the lease is required, but is not to be unreasonably withheld.[45]

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[44] [1995] M.J. No. 447 (Q.B.) (QL) [hereinafter *P&G Cleaners Ltd.*].

[45] *Ibid.* at para. 19.

In support of this finding, Jewers J. cited the case of *Viscount Tredegar* v. *Harwood*[46] In *Viscount Tredegar*, Lord Shaw of Dunfermline distinguished the facts of that case from those involving reasonableness requirements and held that:

> In the present case no such restriction or condition upon the right of the approval or disapproval by the landlord is imposed. The case is the simple one of one sound office being named, with the alternative given of another responsible office approved by the lessor. If the lessee will not insure in the Law Fire Office nor in any other responsible office which the lessor has approved, the covenant is broken. It is a condition precedent to the alternative being resorted to that the lessor's consent has been given to the other office suggested. I am of opinion in these circumstances that this condition precedent cannot be removed or held as satisfied, because in the opinion of a court of law the lessor's refusal was unreasonable. *The Court's opinion upon that subject cannot be allowed to supply the want of the lessor's consent in fact.*
>
> The forms of contract, under which the reasonableness of withholding consent is made a term, are perfectly familiar, and they were not adopted in the present case; and the condition of the lessor's consent is a condition precedent in absolute terms.[47]

Jewers J. did, however, acknowledge that there may be a duty of good faith:

> There may, indeed, be a minimal requirement for the respondent to act in good faith: for example he might at least have to give honest consideration to the applicant's request for the consent.[48]

That there is a good faith requirement in Canadian law with respect to the performance of contractual obligations is clearly stated by Kelly, J. in *Gateway Realty Ltd.* v. *Arton Holdings Ltd.*:

> The law requires that parties to a contract exercise their rights under that agreement honestly, fairly and in good faith. This standard is breached when a party acts in a bad faith manner in the performance of its rights and obligations under the contract. "Good faith" conduct is the guide to the manner in which the parties should pursue their mutual contractual objectives. Such conduct is breached when a party acts in "bad faith" — a conduct that is contrary to community standards of honesty, reasonableness or fairness.[49]

In discussing what exactly a duty of good faith requires in the circumstances where a party is permitted to exercise discretion (and is not required to act reasonably), Jewers J. cited *Canada Egg Products Ltd.* v. *Canadian Doughnot Company Ltd.*,[50] where the Supreme Court of Canada held that the purchaser was within his contractual rights provided he acted honestly, even though he may have acted unreasonably.

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46 [1929] A.C. 72 (H.L.) [hereinafter *Viscount Tredegar*].

47 *Ibid.* at 79 [emphasis added].

48 *Supra* note 44 at para. 26.

49 (1991), 106 N.S.R. (2d) 180 (J.D.) at 191-92, aff'd (1992), 112 N.S.R. (2d) 180 (N.S.C.A.).

50 [1955] S.C.R. 398 at 409.

As there are specific provisions in the 1990 CAPL Operating Procedure which require a party to act reasonably in the exercise of its discretion (*e.g.* clause 2401A), it is submitted that a court will not impose a duty to act reasonably under this exception.

2. Information in the Public Domain

Confidential information can enter the public domain in three ways:

(1) disclosure by the confider;

(2) disclosure pursuant to applicable law; or

(3) disclosure by the confidant or other third parties.

As noted earlier, *Pharand* lists a number of factors which may give certain information the necessary quality of confidentiality. Three factors relevant to determining whether certain information is in the public domain are:

(1) the extent to which the information is known outside the owner's business;

(2) the ease or difficulty with which the information could be properly acquired or duplicated by others through their own independent endeavours; and

(3) whether the owner of the information and the party confided in treat the information as being confidential.

Information that is released into the public domain through the confider will release the confidant of its obligations with respect to that information.[51]

In the context of oil and gas exploration and development, information that is in the public domain includes information released by the Alberta Energy and Utilities Board ("AEUB") pursuant to the *Oil and Gas Conservation Regulations*.[52] This information includes logs, dipmeter surveys, drill stem test data, wire line formation test data, pressure temperature and flow test data, completion details, gas, oil or water analysis data, and sample cuttings or core analysis provided to the AEUB pursuant to the regulations,[53] subject to the following hold periods:

(1) One year from the finished drilling date or suspension date with respect to a well drilled in a "confidential pool";

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51 *Supra* note 15 at 250.

52 Alta. Reg. 151/71.

53 *Ibid.*, Parts 11-12.

(2) On the first day of the month following the expiry of one year from the date of a test, records, reports or information submitted or acquired by the board in respect of:

(a) core analysis pertaining to the estimation or recovery of oil and gas reserves;

(b) bottom hole sample or other pressure-volume-temperature analysis; or

(c) laboratory data or experimental data concerning miscible flood recovery (other than in the case of an experimental well);

(3) Subject to a determination that failure to release the information would severely prejudice the AEUB's position in making decisions or would seriously restrict benefits to conservation in Alberta, five years from the date after approval date (or such longer period as the AEUB considers appropriate) with respect to completion details or evaluation of the performance of an experimental scheme or operation for the recovery or processing of oil or gas that uses methods that are untried and unproven in that particular application; and

(4) Five years from the finished drilling date of a well drilled for the primary purpose of obtaining geological or geophysical information, the log, location and elevation of the test hole.[54]

In addition, pursuant to securities regulation in Alberta, engineering reserve information is required to be included in certain disclosure documents of issuers.[55] Under the Alberta *Securities Act*[56] and the related regulations, rules and policies, disclosure of summary engineering information with respect to proved developed reserves and proved undeveloped reserves must be made in any prospectus filed by a natural resource issuer and in any annual information form filed under National Policy 47 to allow an oil and gas reporting issuer to use the prompt offering qualification system. Furthermore, in circumstances where a natural resource offeror makes a take-over bid and offers its own shares as part or all of the consideration for the shares of the target company, the offeror's take-over bid circular must include prospectus level disclosure relating to the offeror. An issuer bid circular may also be required to include engineering reserve information if the issuer is offering different securities of the issuer in exchange for the securities to be acquired pursuant to the bid. All of these documents

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54 *Ibid.*, s. 12.150.

55 The type of reserve information required in such disclosure documents includes information with respect to the quantity and type of estimated proved and developed reserves (including producing and non-producing properties), and proved and undeveloped reserves (including probable additional reserves) on both a gross and net basis of crude oil, natural gas and natural gas liquids. The annual information form also requires a reconciliation of an issuer's reserves to the previous financial year.

56 S.A. 1981, c. S-6.1.

are contained on the public files of the Alberta Securities Commission, and summary engineering reserve information included therein is therefore in the public domain.

In addition, the Alberta Stock Exchange requires summary engineering reserve information to be set forth in certain documents including a natural resource issuer's initial listing application, an exchange offering prospectus and, in certain circumstances, a filing statement if it is required in connection with material change.

Copies of the engineering reports prepared by an independent engineer[57] with respect to reserve estimates are required to be filed with the Alberta Securities Commission in connection with any long form prospectus filed by a natural resource company and may be requested by the Alberta Securities Commission in connection with any annual information form. Generally, an engineering report provided in connection with a filing of a long form prospectus will be available on the Alberta Securities Commission's public files unless confidentiality is specifically requested and granted. It is also common practice to make engineering reports prepared by independent engineers available for review by the public during the period of distribution of securities under a prospectus and for a period of thirty days thereafter.

In addition to information which enters the public domain through legislative enactments, there may be information that enters the public domain as a result of improper disclosure by a third party. However, notwithstanding such disclosure, it may be argued that the confidant cannot also release this information. The issue arises out of the *obiter dicta* in *Pharand*, wherein Mason J. quoted from a decision of the House of Lords in *U.K.* v. *Observer Ltd.* which held:

> Information may lose its original confidential character if it subsequently enters the public domain. If the confider publishes the information this releases the confidant from his duty of confidence ... the courts have, however, so far refused to extend this principle where the confidential information is published by a third party ... or to the case of publication of the information by the confidant.[58]

The effect of Mason J.'s comments has not gone unnoticed:

> Nonetheless, there is a grey area which arises when private information is disclosed in confidence and then subsequently made public. On the one hand, courts seek to protect the value of the relationship of confidence. A legitimate concern arises as to whether the recipient of confidential information ought to be able to obtain a head start over competitors. On the other hand, where a duty of confidence is enforced after information enters the public domain, this may stifle competition. It may also be unfair to the confidant; if the confidant is prohibited from making use of the information, he or she may be the only person subject to this disability.

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[57] Any oil and gas engineering reports prepared by independent engineers must be prepared in accordance with National Policy 2-B. National Policy 2-B provides some relief of disclosure for reserves assigned to "tight holes" or confidential (by-law) areas which may be grouped and published as a part of the listing as reserves only without identification by location. Alternatively, if they are not included in the reserves listings, there must be appropriate discussion describing the method of handling such properties in the report.

[58] *Supra* note 15 at 250.

> Nevertheless, to date there is no reported decision of a Canadian court decided on this basis. And while it may be justifiable for a court of equity to prevent a confidant from being enriched from his own breach of confidence, *the actions of a third party should in no way prejudice the ability of an individual to act on what is, to the rest of the world, public information.*[59]

It is submitted that McPherson's view on this matter makes good practical sense.

3. Information Released Pursuant to Clause 1801(c)

Clause 1801(c) provides an exception which allows a party to the 1990 CAPL Operating Procedure to disclose confidential information to:

> a third person to which such party *has been permitted to assign* a *portion of its interest* hereunder, provided that a binding covenant is obtained from such party prior to disclosure which provides, *inter alia*, that none of such information shall be disclosed by it to any other third person. [emphasis added]

The annotated version of the operating procedure notes that the 1801(c) exception, *inter alia*, reflects the fact that information is released in practice. While the annotation is helpful as an expression of the intent of the clause, it still must be determined from a legal perspective what are the correct interpretations of the phrases "a person to which a party has been permitted to assign" and "a portion of its interest hereunder."

Arguably, there are two interpretations of the first phrase. The first interpretation is that it applies to a third person who is a permitted assignee under the operating procedure and who *has been assigned a party's interest*. This interpretation leads to the conclusion that the 1801(c) exemption only applies after or in conjunction with the actual disposition of an interest subject to the operating procedure.

The second interpretation is that this phrase applies in circumstances where a party to the operating procedure has, under the terms thereof, "*been permitted to assign*" its working interest to a third party. In other words the assignment to that party is permitted, but has not yet been completed. The effect of this interpretation is that the 1801(c) exemption applies to any prospective purchaser, provided that it is a "permitted assignee" under the terms of the operating procedure.

Obviously, a party to the operating procedure who wants to establish a bidding process for its assets, wherein a number of prospective purchasers are invited to review its assets, will favour the second, broader interpretation of clause 1801(c). The argument that such a party would make is that the language of the operating procedure is equivocal, with the effect that a court may look at "surrounding circumstances."[60] It has been held that the surrounding circumstances that a court may consider in order to interpret an ambiguity in a farmout agreement include "the commercial purpose,

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[59] D.A. McPherson, "Confidentiality and the Public Domain — A Lesson for the Canadian Mining Industry" (1995) 13 J. Energy & Nat. Res. L. 61 at 64, 71 [emphasis added].

[60] *Leitch Gold Mines Ltd.* v. *Texas Gulf Sulphur Co.* (1968), 3 D.L.R. (3d) 161 (Ont. H.C.J.); *Erehwon Exploration Ltd.* v. *Northstar Energy Corp.* (1993), 108 D.L.R. (4th) 709 (Alta. Q.B.).

background, context, or what is sometimes called the commercial matrix in which the farmout agreement was made."[61]

From here, the argument would be made that in the context of significant asset dispositions, the practice in the oil & gas industry is to open bid or data rooms with requirements that the parties who attend these rooms enter into confidentiality agreements and, perhaps, area of exclusion agreements. It would be argued that in the past, because previous CAPL operating procedures do not contain a "clause 1801(c) exception," disposing parties have sought the agreement of their working interest partners to the release of confidential information. However, as a result of the inclusion of clause 1801(c), this is not required under the 1990 CAPL Operating Procedure, provided the confidant is a "permitted assignee."

A "permitted assignee" under the terms of the 1990 CAPL Operating Procedure is likely an assignee to whom a disposition may be made pursuant to the terms of art. XXIV. Under the terms of clauses 2401A and 2402B, a "permitted assignee" is any third person to whom the other parties to the operating procedure provide their consent (which may not be unreasonably withheld) for a disposition of an interest which is subject, in the case of clause 2401B, to the right of first refusal reserved to the existing parties. Clauses 2401A and 2401B each provide that:

> it shall be reasonable for a [party/offeree] to withhold its consent to the disposition if it reasonably believes that the disposition would be likely to have a material adverse effect on it, its working interest or operations to be conducted [under the Operating Procedure, including a] reasonable belief that the proposed assignee does not have the financial capability to meet prospective obligations arising [under the] Operating Procedure.

Accordingly, to the extent that clause 2401 applies to a disposition of assets by a party to the operating procedure, if the broad interpretation of clause 1801(c) is adopted, that party must obtain the consent of the other parties to the operating procedure to a disposition of each of the interested purchasers. However, unlike the exception discussed above (the parties agreeing to a release of confidential information),[62] the other parties cannot unreasonably withhold their consent.

The determination of a "permitted assignee" becomes more complicated in circumstances where there is a disposition by a party which fits within the exceptions set forth in clause 2402 (notably 2402(c) and (d)) of the operating procedure. Clause 2402 describes special dispositions to which clause 2401 does not apply and for which, accordingly, there is no consent required from the other parties to the Operating Procedure. In these circumstances, if the broad interpretation of clause 1801(c) is adopted, it may be argued that the other parties to the operating procedure lose control of the confidential information restrictions because there are no restrictions as to who may be a "permitted assignee" if a disposition is made under clause 2402. It will be

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61 *Lakewood 1986 Development Ltd. Partnership* v. *Fletcher Challenge Petroleum Inc.* (1994), 163 A.R. 115 at 120 (Q.B.).

62 See Part III.C.1, above, "Information the Parties Agree to Release."

recalled that there is an overriding obligation of parties to an agreement to act in good faith.[63] This duty likely prohibits disclosure to third persons who are not *bona fide* interested purchasers in the context of clause 2402.

Notwithstanding the requirement to act in good faith, an argument may be made that the narrow interpretation of clause 1801(c) is the correct interpretation because the broad interpretation appears to open the door to unlimited disclosure by a party of confidential information. However, it should be noted with respect to the broader interpretation that:

(1) There is a qualification in clause 1801(c) which requires that a binding covenant be obtained from the confidant which offers protection to the other parties to the operating procedure. Prudence may dictate that the covenant of the confidant should be in favour of not only the confider of the confidential information, but also the other parties to the operating procedure.[64]

(2) Within the operating procedure (see especially clause 2402) there are exceptions to allow for general corporate activities, including reorganizations, sales of all or substantially all of a corporation's assets and the like to take place free of the limitations imposed under the operating procedure (in the case of clause 2402, the limitations under clause 2401). While the drafting of clause 1801(c) is not clear, arguably, it was the intention of the drafters of the operating procedure to balance the rights of parties to the operating procedure with the interests of each party to carry out its general corporate activities free of unreasonable limitations imposed under the operating procedure.

(3) It prevents a party from unilaterally restricting the right of alienation of property (subject to reasonable limitations) conferred at common law.[65] This may be the case in circumstances where a party can refuse to consent to the disclosure of information which needs to be disclosed in order to make a disposition.

In circumstances where there is to be a sale by way of shares, as opposed to a sale of all or substantially all of the assets of a corporation, the question arises as to whether a potential purchaser of the shares is a "permitted assignee" within the meaning of art. XXIV. An argument may be advanced that the definition of disposition under clause 2401 ("by assignment, sale, trade, lease, sublease, farmout *or otherwise*") is broad enough to cover a disposition of shares. This argument would be easier to advance if the words "directly or indirectly" were included in the definition.

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63 *Ibid.*

64 See Part V.B.1, below, "Trust of the Covenant."

65 It is noted that an argument may be advanced that the ability of a party to the operating procedure to effectively prevent a disposition of property by another party by withholding its consent to the release of confidential information is an undue restraint of alienation. This argument will likely only be successful in circumstances where the facts warrant, and accordingly, this issue is not addressed in this article.

A further complication arises with respect to the phrase "portion of its interest." This wording may lead to an argument by a party that a confider of information is not permitted to disclose confidential information pursuant to clause 1801(c) in circumstances where it is assigning its entire interest in the assets that are subject to the operating procedure. On the other hand, it could be argued that this reference is inserted for the purpose of being inclusive as opposed to exclusive. In other words, the phrase confirms that clause 1801(c) is intended to apply to both partial assignments and entire assignments. The second argument is supportable on the basis that, if this phrase is intended to be exclusive, the intent can be defeated by completing two transactions consisting of partial assignments. In addition, there appears to be no commercial reason for limiting the scope of clause 1801(c) in this manner, and the second position is supported by the legal principle that a court will always attempt to avoid any contractual interpretation that would result in a commercial absurdity.[66] Consequently, where there is both an absurd and a reasonable interpretation of a contractual clause, a court will assume that the reasonable interpretation represents the intention of the parties.

Like the other exceptions to the requirements to keep confidential all information disclosed pursuant to the operating procedure and the agreement to which it is incorporated, clause 1801(c) was not inserted into the CAPL operating procedures until the 1990 version. In reviewing the annotated version, it is clear that the intent of the drafters is to allow the disclosure of confidential information to permitted assignees, and it is submitted that it is the intention of the drafters to allow for parties to the operating procedure to disclose information to interested purchasers so as to allow dispositions at prices that reflect complete disclosure of information. However, in the next version of the operating procedure, the drafters may wish to consider reviewing the current wording of clause 1801(c) to clarify its scope.

IV. REMEDIES FOR BREACH

A. GENERALLY

The remedies available to a confider in an action against a confidant based on breach of confidence include:[67]

(1) damages (based upon the ordinary rules of common law) for loss or injuries suffered by the confider, or punitive or exemplary damages in extreme circumstances, as a result of the confidant's conduct;

(2) an accounting of profits earned by the confidant by an unauthorized use or disclosure of the confidential information (this remedy is mutually exclusive to damages);

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[66] *Toronto (City)* v. *W.H. Hotel Ltd.*, [1966] S.C.R. 434.

[67] *Supra* note 17 at 336-67; M. Goudreau, "Protecting Ideas and Information in Common Law Canada and Quebec" (1994) 8 I.P.J. 189.

(3) injunctive relief in the form of either an interim or permanent injunction (an innocent third party who acquires information without knowledge of its confidentiality may also be restrained from using it) prohibiting the confidant from using or disclosing the information;[68]

(4) an order for delivery up and destruction is usually part of an injunctive order whereby the confidant is ordered either to deliver up to a confider on oath or to destroy any materials which it acquired improperly through the unauthorized use of the confider's information; and

(5) constructive trust.

B. RIGHTS IN RESPECT OF AN INTERIM INJUNCTION

In instances where a party wishes to prevent a confider from disclosing (or further disclosing) confidential information, an interim injunction must to be sought prior to the disclosure (or further disclosure) of the information, since after the information is disclosed an injunction is no longer of any benefit.[69] Accordingly, in the case of a disposition of oil and gas assets or shares, when a bid or data room is announced or opened, if the disposing party proposes to release confidential information that is subject to confidentiality obligations to third parties, the parties to whom those obligations are owed may seek to prevent disclosure by way of interim injunction.

1. General Principles

An interim injunction is a discretionary remedy which is governed by principles of equity. In general,[70] to be successful in obtaining an interim injunction, a party must meet a sequential three-step test. In particular, the party seeking the injunction must establish the following:

(1) there is a serious issue to be tried;

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[68] Because interim injunctive relief is the only remedy which is prospective (it can be used to prohibit disclosure), it is the only remedy discussed in this article.

[69] Indeed, in circumstances where the confider of confidential information has duties of non-disclosure with respect to such information, it may be tempted to make disclosure of that confidential information under confidentiality agreements with a confidant, knowing that the only remedy of the parties to whom it owes a duty is effectively monetary, and this should only arise if the confidant breaches the terms of its confidentiality agreement. To the extent that the party to whom the confider owes obligations has a claim against the confider, the confider will have a claim over against the confidant for breach of the confidentiality agreement.

[70] *Ominayak* v. *Norcen Energy Resources Ltd.* (1985), 58 A.R. 161 (C.A.), leave to appeal denied (1985), 36 Alta. L.R. (2d) lxi (S.C.C.); *Erickson* v. *Wiggins Adjustments Ltd.*, [1980] 6 W.W.R. 188 (Alta. C.A.) [hereinafter *Erickson*]; *Law Society of Alberta* v. *Black* (1983), 8 D.L.R. (4th) 346 (Alta. C.A.); *RJR-MacDonald Inc.* v. *Canada (A.G.)*, [1994] 1 S.C.R. 311 [hereinafter *RJR-MacDonald Inc.*].

(2) there would be no fair and reasonable redress available if there were no interim relief (*i.e.* there would be irreparable harm if an interim injunction were not granted); and

(3) in considering all relevant factors, the balance of convenience favours the granting of the interim injunction.

2. Serious Issue To Be Tried

The question as to whether there is a "serious issue to be tried" is generally a fairly easy standard to meet. Courts tend to be generous in this area,[71] saving more serious judicial scrutiny for the remaining two tiers of the test. The Supreme Court of Canada in *RJR-MacDonald Inc.* stated:

> Once satisfied that the application is neither vexatious nor frivolous, the motions judge should proceed to consider the second and third tests, even if of the opinion that the plaintiff is unlikely to succeed at trial. A prolonged examination of the merits is generally neither necessary nor desirable.[72]

3. Irreparable Harm

The standard of proof of irreparable harm in this circumstance is that of "doubt." Rather than having to prove that damages would not adequately compensate for the respondent's breach of contract, the applicant need only show that it is doubtful that damages would do so. As such, in order to establish irreparable harm, an applicant would have to show that it is doubtful that damages are capable of being determined or calculated with reasonable accuracy. In proving irreparable harm, the evidence must be clear and not speculative, that is, there must be some real risk of damages occurring.[73]

The Alberta Court of Appeal has held that where there is a "clear breach of a clear covenant," it is not necessary to prove irreparable harm. In *Canada Safeway Ltd.* v. *Excelsior Life Insurance Co.*,[74] Canada Safeway applied for an interim injunction to stop a landlord from proceeding with new construction at a shopping centre. Canada Safeway maintained that a provision of its lease gave it a right to consent to the construction. Speaking for the Court, Kerans J. held that in the case of a clear breach of a clear covenant it is unnecessary for an application for an injunction to show irreparable harm. However, he noted that no such clear covenant existed in this case as it was not an instance of an "undisputed and indisputable breach of contract."

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71 See *e.g. Erickson, ibid.*; *RJR-MacDonald Inc., ibid.*

72 *RJR-MacDonald Inc., ibid.* at 337-38.

73 *Syntex Inc.* v. *Novopharm Ltd.* (1991), 36 C.P.R. (3d) 129 at 135 (F.C.A.); *Edmonton Northlands* v. *Edmonton Oilers Hockey Corp.* (1993), 23 C.P.C. (3d) 49 (Alta Q.B.); *Amoco Canada Petroleum Co.* v. *Alberta and Southern Gas Co.* (1992), 130 A.R. 252 (Q.B.).

74 (1987), 82 A.R. 316 (C.A.). See also *West Edmonton Mall Ltd.* v. *McDonald's Restaurants of Canada Ltd.* (1993), 141 A.R. 266 (C.A.).

This view was adopted by the Alberta Court of Queen's Bench in the case of *Debra's Hotels Inc.* v. *Lee.*[75] In this case, the plaintiff owned a hotel and the defendant owned the adjacent shopping centre. A restrictive covenant prohibited the shopping centre owner from permitting the leased premises to be used as a "restaurant with a cocktail lounge" or a "sit down restaurant." The shopping centre owner entered into a lease with a tenant to open a cappuccino bar. Hunt J. allowed an application for an interlocutory injunction holding that this was a case of a "clear breach of a clear covenant"[76] and that it was therefore unnecessary to show irreparable harm. Hunt J. held that a consideration of damages suffered by the parties was inherent to the test relating to the balance of convenience and remained part and parcel of the examination when granting an injunction. She found that the plaintiff need show only harm, not irreparable harm.

The effect of this line of cases is important in the context of dispositions. In circumstances where the applicable agreement prohibits disclosure of confidential information, third parties may be able to prevent the confider from opening a bid or data room, notwithstanding that the confider has taken all reasonable steps to ensure that interested purchasers use the information provided to them for the sole purpose of evaluating the confider's assets by requiring the execution of confidentiality agreements. Third parties may in an injunction application acknowledge that they cannot establish irreparable harm. They may, however, argue that establishing irreparable harm is unnecessary because there is a clear breach of covenant.[77]

4. Balance of Convenience

Once the first two tests are satisfied, an applicant must then demonstrate that the balance of convenience favours the granting of an interim injunction. In the context of the disclosure of information that is subject to confidentiality obligations to third parties, it is submitted that a court will weigh the harm that those third parties may suffer if the confidential information disclosed by the confidant is improperly used or disclosed by the confidants against the prejudice that may be suffered by the disposing party if the injunction is granted. The fact that the confidants are subject to confidentiality agreements should be viewed by the courts as an indication of a reduction of harm that may be suffered by third parties. This may especially be the case if the third parties can enforce the obligations of the confidants under the confidentiality agreement, either as parties, or as beneficiaries of a trust.[78]

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[75] (1994), 24 Alta. L.R. (3d) 199 (Q.B.).

[76] *Ibid.* at 209.

[77] Because of the wording of clause 1801(c) of the 1990 CAPL Operating Procedure, it is likely not possible to establish a clear breach of a covenant, but this may not be the case with the earlier CAPL operating procedures where there are no exceptions to the disclosure of confidential information. See Part III.B and C, above.

[78] See Part V.B.1, below, "Trust of the Covenant."

5. Undertaking as to Damages

The courts have held that an applicant's financial ability to give an appropriate, meaningful and enforceable undertaking as to damages is a perequisite to its right to obtain an injunction.[79] The Alberta Court of Appeal has recognized that an undertaking as to damages is an integral component of the balance of convenience.[80]

Further, the Alberta Court of Queen's Bench in *Ominayak* v. *Norcen Energy Resources Ltd.* stated:

> That loss coupled with the admitted inability of the applicants to give a meaningful undertaking to the court as to damages either as individuals, or if authorized to bind the known class, as a class, on which point I have grave doubts, reinforces my decision that injunctive relief in this case is not appropriate.[81]

It is submitted that in the context of disclosure of confidential information for the purpose of dispositions, the courts will scrutinize any application for an injunction very carefully. Dispositions are a common occurrence in the oil and gas industry, and in circumstances where a party takes all reasonable steps to prevent the improper use or disclosure by confidants of confidential information, the courts should find that there is no real risk of damages occurring or that an alternative remedy will be adequate[82] if the third parties suffer detriment. Courts should not grant interim injunctions unless there are special circumstances.

V. ISSUES IN NEGOTIATING AND DRAFTING CONFIDENTIALITY AGREEMENTS

In negotiating and drafting confidentiality agreements, there are a number of general and specific considerations that should be addressed. The following is a list and a discussion of the significant considerations.

A. GENERAL CONSIDERATIONS

1. What Information is Confidential

The interests of the confider and the confidant as to what information is confidential and therefore, subject to the confidentiality agreement will tend to be divergent. Richard A. Brait observed:

> The confidant will strive to have the agreement as definite as possible, with very stringent rules as to what will be held in confidence. His interest is to know exactly what information it is that he has to treat with additional care, and exactly what that additional amount of care is. The confider, on the other

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79 See *e.g. Stevens* v. *Westfair Foods Ltd.* (1990), 83 Sask. R. 10 at 13 (Q.B.).

80 *Lac La Biche (Town)* v. *Alberta* (1993), 9 Alta. L.R. (3d) 225 at 231 (C.A.).

81 (1983), 29 Alta. L.R. (2d) 151 at 158.

82 See Part IV.A, above.

hand, will want an agreement which imposes relatively onerous requirements on the confidant, but which defines the information subject to confidentiality requirements in a relatively broad way.[83]

However, in the oil and gas industry, a confidentiality agreement will generally provide that all information furnished by the confider is confidential, or it may limit such information to information that is "non-public, confidential and proprietary"[84] in nature. This may be a meaningless distinction based upon the exceptions to disclosure discussed below.

To the extent that confidential information may have already been provided by the confider, consideration should be given to cover information disclosed prior to the execution of the confidentiality agreement. The confider should also consider expressly clarifying that all interpretive reports and other data generated by the confidant that are based in whole or in part on the information provided by the confider are also confidential.

2. Exceptions to Confidential Information

There are three exceptions to the confidentiality obligations that should be included in a confidentiality agreement, namely information:

(1) already in the public domain or which subsequently becomes part of the public domain without fault of the confidant;

(2) that was in the possession of the confidant at the time the information was disclosed and was not directly or indirectly acquired under an obligation of confidence; or

(3) that was received by the confidant from a third party who did not acquire it directly or indirectly from the confider under an obligation of confidence.

The burden of proof with respect to whether information was or was not subject to one of the three exceptions should be considered. Generally, the confider will require that the confidant establish that the information was obtained by the confidant pursuant to one of the exceptions. This is because the confider will have difficulty (especially

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[83] R.A. Brait, "The Unauthorized Use of Confidential Information" (1991) 18 Can. Bus. L.J. 323 at 339.

[84] In Canada, there may not be property in confidential information, so a reference "proprietary" may be of little effect. In *R.* v. *Stewart*, [1988] 1 S.C.R. 963 at 979, rev'g (1983), 42 O.R. (2d) 225 (C.A.) Lamer J. held that "as a matter of policy, confidential information should not be property for the purposes of s. 283 of the [*Criminal*] *Code*," although for civil purposes it may be entitled to protection. He further held that "it appears that the protection afforded to confidential information in most civil cases arises more from an obligation of good faith or a fiduciary relationship than from a proprietary interest. No Canadian court has so far conclusively decided that confidential information is property, with all the civil consequences that such a finding would entail. The case law is therefore of little assistance to us in the present case. It is possible that, with time, confidential information will come to be considered as property in the civil law or even be granted special legal protection by statutory enactment," *ibid.* at 975-76.

in relation to the second and third exceptions) establishing that the information was not obtained by the confidant pursuant to one of the exceptions.

With respect to the first exception, the phrase "or which subsequently becomes part of the public domain without the fault of the confidant" is important to the confidant. This negates the possible application of the *obiter dicta* of Mason J. in *Pharand*.[85]

With respect to the third exception, consideration should be given to the words "under an obligation of confidence." A broad interpretation of these words will include contractual, legal, equitable or fiduciary obligations. The confidant may want to limit it to a "contractual obligation of confidence" because it may not be able to determine that such information is subject to a fiduciary or other obligation of non-disclosure.

3. Use and Disclosure of Confidential Information

A confidentiality agreement will generally provide that the confidential information is to be used solely for the purpose of evaluating a possible transaction involving the confider and the confidant. It should prohibit the use of the information for any other purpose. The confidant should resist the insertion of any provision that it holds the confidential information or the benefits arising from its improper use of the confidential information in trust for the confider. A clause of this nature will raise its duty to the confider to the standard of a fiduciary.

The confidentiality agreement should also provide that the information will only be disclosed to those representatives of the confidant who need to know such information. The agreement should require that representatives to whom confidential information is disclosed are informed of the confidential nature of the information or are required to provide a confidentiality undertaking to the confider agreeing to be bound by the terms of the agreement. In any event the confidant should indemnify the confider against improper use or disclosure of the confidential information by it or anyone to whom it makes disclosure.

One further limitation on disclosure that a confidentiality agreement may impose is a prohibition against disclosure of the fact that the information itself has been received by the confidant, with an additional requirement that the confider must consent to any proposal for joint bids to be made by the confidant with any other person.

The confidentiality agreement should provide that the confidant may disclose the confidential information under compulsion of law. From a confider's perspective, consideration should be given to provide in the confidentiality agreement for the right of the confider to become party to any action compelling disclosure and to allow it to defend the proceeding.

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[85] *Supra* note 15. See Part III.C.2, above, "Information in the Public Domain."

4. Requirement to Disclose Information

In the context of a disposition, the confider does not usually covenant to disclose information. The nature and extent of the disclosure is at the confider's discretion. However, if the confider does provide such a covenant, parameters should be established as to when and what information will be provided.

5. Disclaimer as to Information

Because of the nature of the information disclosed in the context of oil and gas dispositions, generally, the confidant should acknowledge that the confider is not making any representation or warranty as to the accuracy or completeness of the information, and that liability to the confider will not result from the use of the information by the confidant. A confidant should ensure that this disclaimer is subject to the terms of any definitive agreement relating to the proposed transaction.

6. Non-solicitation of Employees

A confidentiality agreement may contain a covenant from the confidant that it will not employ or directly solicit employees of the confider. This was demonstrated in the case of *Chevron Standard Ltd.* v. *Home Oil Co.*[86] where it was held that the possibility of misuse of confidential information by the former employee is not a sufficient threshold for the former employee to obtain legal redress. This clause simply prevents by contract what the confider will not be able to prevent at law. Consideration should be given to restrictions on its scope (*i.e.* limit in time and to specified employees) to ensure that it is not held to be invalid for public policy reasons.

7. Return of Information

Generally speaking, confidentiality agreements provide that, if requested by the confider, the confidant will return all information (together with copies) provided by the confider. However, there may be an issue with respect to interpretative reports and data and other material that is generated by the confidant from the information provided by the confider. The confidant will likely not want to return interpretative information to the confider and, accordingly, the confidant should ensure that its obligation with respect to this type of information is to destroy it. The confidant should also consider inserting into the confidentiality agreement an exception to the destruction requirement for interpretive information that has been considered by the directors of the confidant and which forms part of the minutes of meetings of its directors, as they form part of the corporate records of a corporation.

8. Survival of Legal Obligations

A confidentiality agreement may provide that the obligations of the confidant under a confidentiality agreement will survive for a limited period. Usually, if there is a

[86] (1980), 22 A.R. 451 at 493-96 (Q.B.), aff'd (1982), 19 Alta. L.R. (2d) 1 (C.A.).

closing of a proposed acquisition transaction with the confidant, its obligations under the confidentiality agreement will terminate on the closing. If there is no transaction, the survival period for the confidentiality agreement may be for a period as short as one year. In the oil and gas context, if the nature of the confidential information to be disclosed by the confider relates to reserves and production, the survival period is not likely to be an issue because the information will fall into the public domain in any event.[87] However, this may not be the case with other types of information.

In most circumstances, the confider will not be concerned about disclosure of confidential information after the closing of an acquisition transaction because it will have sold the shares or assets to which the confidential information pertains. Accordingly, the problem rests with the bidder who is successful in completing the transaction because all of the rival bidders will be entitled to use and disclose the information obtained by them after expiry of the survival period.

9. Right to Injunctive Relief

While injunctive relief is likely available in circumstances where confidential information is used or disclosed in breach of the agreement, it has been suggested that a clause of this nature has merit for two reasons:

> First, it stresses to the party to whom the confidential information or material is being given that the disclosing party regards any unauthorized disclosure of such information or material as extremely serious. Second, it provides evidence to the court that this is indeed a case where the special relief of an injunction is appropriate.[88]

10. Entire Agreement Clause

It was noted in *Cadbury Schweppes*[89] that common law and equity may supplement a confidentiality agreement. However, the confidant may take the position that the confidentiality agreement sets forth all of the rights and obligations as between the parties, and there are no further rights or obligations. If this is the case, a provision should be inserted to the effect that there are no express or implied terms, conditions, representations or other commitments, or other duties, whether legal, equitable, fiduciary or in tort among the parties unless expressly provided for in the confidentiality agreement.

In drafting a clause of this nature, consideration should be given to whether the confidentiality agreement will be superseded or supplemented by a definitive agreement and to whether the confidentiality agreement itself supplements or supersedes any prior confidentiality agreements.

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87 See Part III.C.2, above, "Information in the Public Domain."

88 C.I. Kyer, "Contracting for Injunctive Relief: Is it Effective?" (1986), 3 C.C.L.R. 165 at 168.

89 *Supra* note 1.

B. SPECIFIC PROVISIONS

1. Trust of the Covenant

Under a confidentiality agreement, the confider of confidential information may be interested in protecting third parties interested in the confidential information, typically, other parties to joint operating agreements. These other parties can be protected if they are made parties to the confidentiality agreement. However, for a number of reasons, including logistics, this may not be practical. The issue is if the confidant breaches the contract with the confider, can the other parties to the operating procedure sue the confidant if they are not parties to the confidentiality agreement?

One of the exceptions to the privity of contract rule is the creation of a trust. If it can be established that the confider is a trustee for specified third persons then this trust relationship will give the other persons the right to sue the confidant if it breaches its contract with the confider. The leading case regarding this exception to the privity of contract rule is *Greenwood Shopping Plaza Ltd.* v. *Beattie*, wherein McIntyre J. recognized the principle of the trust of the covenant:

> The other avenue of escape for the respondents would be that of trust. To succeed upon that footing, the respondents would have to show that for the purposes of the covenants in paras. 14 and 15, the company was contracting as their trustee.[90]

This same principle has also been accepted in Alberta in the case of *Alberta (A.G.)* v. *Samuel Doz Professional Corp.*[91] As noted in both *Greenwood Shopping Plaza* and *Samuel Doz*, one part of the test to be applied in determining whether or not a trust exists is as follows:

> A common test applied to determine whether a trust has been created has been to pose the question whether the parties to the contract could change the contractual terms without reference to the alleged *cestui que trust*. If the answer is yes, no trust has been created.[92]

It is important to note, however, that the courts tend to be reluctant to find that a trust exists where the intention to create a trust is not expressly set forth. D.W.M. Waters explains that there is a "dividing line" between a trust and a contract benefiting a third party:

> Here is the heart of the matter; "a dividing line" is drawn between trust and such a contract. Unhappily, however, enquiry by the Courts into the location of this line has proceeded along the lines that it lies between contract and trust of express or construed intent only. That is to say, the Courts are concerned to discover whether the parties to the contract intended, as revealed by the language of the contract, that the promisee become a trustee of the benefit of the contract for the third party.[93]

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90 (1980), 111 D.L.R. (3d) 257 at 264 (S.C.C.) [hereinafter *Greenwood Shopping Plaza*].

91 (1993), 9 Alta. L.R. (3d) 201 (Q.B.) [hereinafter *Samuel Doz*].

92 *Supra* note 90 at 265.

93 D.W.M. Waters, *Law of Trusts in Canada*, 2d ed. (Toronto: Carswell, 1984) at 52.

It should also be noted that in *Greenwood Shopping Plaza* McIntyre J. did not find that a trust existed as there was no evidence from which a trust could be inferred. Furthermore, Ritter J. also found in *Samuel Doz* that a trust did not exist since the respondents were able to amend the contract without the consent of the appellants.

Finally, in order to ensure that a trust has been created, the express use of the word "trust" is important to show adequately the intentions of the contracting parties to create a trust. This is specifically noted by Professor S.M. Waddams:

> The device of trust, although accepted in principle by the highest courts, has been severely reduced in effect by insistence on a "real" intention to create a trust. The meaning of intention in this context is uncertain. The Supreme Court of Canada, in *Greenwood Shopping Plaza Ltd.* v. *Beattie*, accepted that a promisee might contract as trustee for a third party but declined to find a trust in the absence of sufficient evidence. It seems clear that the express use of the word "trust" would be sufficient to create rights in the third party. It is not clear, however, what conduct short of express use of the word "trust" sufficiently manifests an intention to create a trust.[94]

Accordingly, it may be possible for a confidentiality agreement to contain an acknowledgement and declaration that the confider holds the benefits of the confidentiality covenants made by the confidant contained therein in trust for the benefit of specified[95] third parties. If there is to be an acknowledgement of this nature, there must be an express declaration of trust by the confider for the benefit of the third parties and an acknowledgement that there will be no waiver or amendment of the terms of the confidentiality agreement without the consent of the third parties.

While a covenant of trust is convenient because it dispenses with the necessity of the third parties becoming signatories to the confidentiality agreement, the confider of the information should consider two things:

(1) It may have fiduciary obligations to the third parties with respect to the benefits of the confidant's covenants held in trust. Accordingly, in the event of a breach by the confidant of the confidentiality agreement, the third parties may bring an action against the confider on the basis that it did not diligently ensure compliance by the confidant with its obligations under the agreement.

(2) The third parties may be entitled to compel the confider to bring an action against the confidant under the confidentiality agreement in circumstances where it may not desire to do so.

These two concerns should be alleviated by expressly limiting their effect in the confidentiality agreement.

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[94] S.M. Waddams, *The Law of Contracts*, 3d ed. (Toronto: Canada Law Book, 1993) at 184.

[95] It is likely sufficient for the third parties to be identified by a class (*i.e.* other parties to a specified operating agreement), as long as they are identifiable.

2. Standstill Covenant

In circumstances where the confider (or a parent of the confider) is a publicly traded corporation, it is likely that the confidentiality agreement will prohibit any negotiations, solicitations or agreements to vote, acquire or otherwise deal in any securities or assets of the confider or its affiliates without the approval of the confider's (or its parent's) directors. The purpose of this restriction is to allow the directors to assume control over the ability of a confidant to use the information obtained by it to acquire shares or other securities of the confider (or its parent).

In circumstances where a hostile take-over bid has been initiated against a target corporation, the target corporation may open a data room in an effort to attract better offers and gain some control over the bid process. Entry by potential bidders may be subject to the execution of a confidentiality agreement with a standstill covenant. If the hostile bidder wants access to the bid room, it is required to enter into a confidentiality agreement containing the standstill covenant. Any further bids are then subject to the approval of the confider's (or the parent's) directors.

While open to challenge, the utilization of standstill covenants in confidentiality agreements will likely not, in and of themselves, be held invalid in competitive bid situations. The Ontario Court (General Division) has held that a bidder has no standing to challenge prospectively the way a target corporation may conduct its bid process.[96] Similarly, the Delaware Court of Chancery has refused to exercise its equitable jurisdiction to provide relief from the consequences of a party failing to agree to the terms of a standstill in circumstances where confidential information is offered to all bidders on the same terms and the standstill has not been used for some inequitable purpose.[97]

3. Area of Exclusion Covenant

Perhaps the most contentious aspect of a confidentiality agreement is a requirement that the confidant enter into an area of exclusion covenant. This is an attempted duplication of the remedy granted by the courts to Corona in the *LAC Minerals* case. The difference is that the area of exclusion covenant is effective, notwithstanding that there may not have been any improper use of confidential information by the confidant in the acquisition of the interest that is subject to the covenant. However, it is difficult for a confider to establish that the confidential information provided by it has been improperly used. While not generally provided for in practice, a confidant may attempt to negotiate an exception to the application of the area of exclusion covenant if it can establish that it did not use any confidential information provided by the confider to acquire the interest.

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[96] *Rogers Communications Inc.* v. *Maclean Hunter Ltd.* (1994), 2 C.C.L.S. 233 at 248 (Ont. Ct. (Gen. Div.)).

[97] *Re J.P. Stevens & Co. Shareholders Litigation*, [1987-8] Fed. Sec. Law Rep. 98,377 at 98,387.

The same considerations in the drafting of an area of mutual interest agreement will be involved in the drafting of an area of exclusion covenant, namely:

(1) determining the cash value of non-cash consideration for the interest;

(2) dealing with acquisitions by the confidant through farmout and similar agreements that contain restrictions on assignments of those agreements; and

(3) exceptions to the application of the area of exclusion covenant in circumstances where the acquisition of the new interest forms a minor part of an acquisition by the confidant.

VI. CONCLUSION

There are unique issues that arise in connection with the protection against improper use or disclosure of confidential information in the context of oil and gas dispositions. The confider, in connection with a disposition, must be cognisant of its interests and also the interests of other parties to which it is contractually bound prior to releasing sensitive information for review by interested purchasers.

The general duty of confidence owed by a confidant of confidential information is wide ranging, and can be a useful substitute or supplement to express confidentiality agreements. The duties of a confider of information to third parties to which the confider has obligations of confidentiality must be balanced with its needs to disclose the information in connection with the disposition of its assets.

Finally, there are a number of special considerations involved in the negotiation and drafting of confidentiality agreements in the context of oil and gas industry dispositions which should be carefully considered.