RECENT JUDICIAL DEVELOPMENTS OF INTEREST TO OIL AND GAS LAWYERS

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This article is a compilation of recent Canadian decisions pertaining to oil and gas law. The authors have dealt with a variety of cases in such areas as land leases and titles, royalty agreements, contracts, surface rights, administrative law, tax, director's liability, creditor's rights and aboriginal oil and gas. The briefs include comments by the authors.

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I. INTRODUCTION

This article covers decisions which were released between May 1995 and May 1996. In the past year there have been a number of Canadian decisions pertaining to oil and gas law in various areas. We have placed particular emphasis on those decisions which, in our opinion, are of greatest significance to oil and gas lawyers. Due to the large number of cases, the decisions noted in this article are neither a complete list of all relevant cases, nor is each case brief a complete discussion of all the issues in the case. Therefore, we include the usual disclaimer that our case summaries should not be relied on in place of the reader's review of the decisions. Also, the opinions expressed are those of the writers only and not of Amoco Canada Petroleum Company Ltd., Milner Fenerty or the Canadian Petroleum Law Foundation.

II. LANDS, LEASES AND TITLES

A. *FLECK* v. *DAVIDSON ESTATE*[1]

This case involved a question of priority between the holder of an equitable but unregistered interest in land and the holder of a clear certificate of title. The holder of the certificate of title had contractually agreed to honour the equitable charge on the land prior to purchasing the property and had acted in a manner consistent with that contractual agreement for fifteen years after he obtained title to the property.

1. Facts

When a father sold his farm to his son, he reserved the right to a rent charge from four surface leases which he had granted to oil companies. The son later granted the plaintiff an option to purchase, which provided that the benefit of the surface leases would not be transferred to the plaintiff. The plaintiff exercised the option and obtained a fee simple title encumbered by caveats protecting the surface leases but not the rent charge reserved by the option agreement. For fifteen years the plaintiff consented to the oil companies paying rentals to the father or his estate. The plaintiff then applied under s. 237 of the Saskatchewan *Land Titles Act*[2] for a declaration that he was entitled to receive the rentals. Section 237 provides as follows:

> 237(1) No person contracting or dealing with or taking or proposing to take a transfer, mortgage or lease from the owner of any land for which a certificate of title has been granted shall, except in the case of fraud by such person, ... be affected by notice direct, implied or constructed of any trust or any unregistered interest in the land, any rule of law or equity to the contrary notwithstanding.

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1 [1996] 1 W.W.R. 686 (Sask. Q.B.).
2 R.S.S. 1978, c. L-5.

(2) Knowledge on the part of any such person that any trust or unregistered interest is in existence shall not of itself be imputed as fraud.

2. Decision

Justice Kyle noted that, on its face, s. 237 appears to have the effect of enabling a purchaser to take advantage of the owner of a known but unregistered interest in land, even in the face of a contrary contractual obligation as between the purchaser and the vendor. However, he noted that the Court was a court of equity, as well as a court of law, and that it was repugnant that the Court be called upon to vest in an applicant an interest which he has previously recognized to be the property of another, both before and after receiving his transfer under the *Land Titles Act.* Kyle J. acknowledged that the vendor could have registered a caveat to protect the rent charge, but held that the effect of the caveat was purely one of notice to a potential purchaser from the registered owner. There was no need for notice to the plaintiff, as the contract under which he had acquired his right to a transfer specifically reserved the rent charge from the lands being optioned.

Kyle J. rejected the plaintiff's argument that the rights which arose from the option agreement were merged in the transfer and effectively disappeared upon the registration of the transfer and the issuance of a new unencumbered title. He held that unless the provisions of the *Land Titles Act* barred the relief sought by the defendant, the Court in its equitable jurisdiction, should deal with the rights of the parties on the footing of there being no merger. The fact that the rent charge had been recognized and allowed to continue in the hands of its holder for a period of about fifteen years showed that there was no intention to merge the rent charge.

Kyle J. relied on the summary of the law provided by V.D. diCastri in *Registration of Title To Land*:

> In any event it was never intended that a registered owner, merely by exhibiting a certificate of title, should be able to escape the performance of contracts he has entered into prior to, contemporaneously with or subsequent to the registration of his interest, or to deny a trusteeship which he has created or one which may be fastened upon him by law. As between transferor and transferee, the doctrines of equity as to mistake, accident, rectification and constructive trusts continue to operate. The owner of an unregistered equitable interest, of course runs the risk of his interest being cut out by the intervention of a *bona fide* purchaser for value.[3]

Therefore, Kyle J. refused to grant a declaration that the rent charge should go to the plaintiff purchaser.

3. Comments

On first examination this appears to be a case on the question of priority between an equitable but unregistered interest in land and the holder of a clear certificate of title.

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3 Vol. 2 (Toronto: Carswell, 1987) c. 18-19, para. 766.

However, the case does not turn on the issue of notice of the prior charge but rather on the plaintiff's agreement to be bound by that charge as well as the fifteen years of action consistent with that contractual promise. The certificate of title acts as notice to other third party purchasers who are not in a contractual relationship with the original vendor.

B. *GANNON BROS. ENERGY LTD.* v. *ALBERTA (ENERGY AND UTILITIES BOARD)*[4]

This case involved the question of whether the plaintiff's oil well was drawing from a particular pool.

1. Facts

The Alberta Energy and Utilities Board (the "Board") made a decision that a well owned by Gannon Bros. Energy Ltd. belonged to a certain pool that was being operated by Ranger Oil Ltd. ("Ranger"). Mr. Gannon appealed and argued that his well was not drawing from the Ranger pool.

2. Decision

Kerans J.A. held that the Examiners of the Board had found that Gannon was unable to persuade them on a balance of probabilities that he was in a separate pool. The Board was entitled to say that this burden rested on Gannon and was not met. Gannon had misunderstood the purpose of waterflood production ordered by the Board. The purpose of the waterflood production was not to demonstrate whether or not Mr. Gannon was in the pool but rather to encourage conservation. The appeal was dismissed.

3. Comments

This decision upholds the traditional position that where the Board has designated a well to a particular pool, that well should be kept in the pool to safeguard conservation and equity until the well owner can persuade the Board on a balance of probabilities that the well does not belong in the pool.

C. *WOLFF* v. *CONSUMERS' GAS CO.*[5]

The issue in this case was whether a lease which was in its secondary term had expired because the lessee had failed to produce for a period of longer than ninety days. This case is another in the rather long line of cases which establish that where an act or omission terminates a lease under the habendum clause, the default provisions of the lease will not save it.

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4 (18 January 1996), Calgary 15811 (C.A.).

5 (22 December 1995), 4731/94 (Ont. Ct. (Gen. Div.)).

1. Facts

The applicants owned adjoining pieces of property and sought declarations that petroleum and natural gas leases which had been registered against their lands since 1965 had expired. The respondent assumed the position of lessee in 1991. The oil wells continuously produced, within the terms of the leases, until February 1992 when production ceased. Since production had ceased, the respondent had failed to maintain the wells which were unpainted and overgrown with weeds.

2. Decision

The leases in question had a primary period of ten years starting in 1965. Production had first been obtained in 1970 and had been constantly maintained since that time until 1991 when the respondent assumed the position of lessee. The third proviso clause in the lease provided: "this lease shall remain in force so long as any drilling or production operations are prosecuted without cessation of more than ninety (90) consecutive days...." There was no dispute that production had ceased in February 1992 and had never recommenced. The respondent put forward two arguments as to why the lease might still be in force. First, it argued that production on one of the wells had ceased due to a fire which had been beyond the lessee's control. Secondly, it argued that failure to produce was a default under the lease and thus the respondent was entitled to the benefit of the default provision which required the lessor to give notice and provide the lessee with ninety days in which to remedy the default.

Day J. rejected both arguments of the respondent. Although a fire at one of the wells may have been a situation beyond the control of the lessee, that had not prevented production from other wells on the property. Regarding the default provision, Day J. held that production was not required of the lessee in either of the primary or the secondary terms and the decision to produce was at the lessee's option. If the lessee chose not to produce, it was not a default under the lease and therefore the lessee was not entitled to the default provision. Day J. followed *Durish* v. *White Resource Management Ltd.*[6] which held that during the secondary term, the lessee must resume production within ninety days after an interruption of production, unless the interruption is beyond the lessee's reasonable control. In this case, there was no evidence to establish that interruption was beyond the reasonable control of the lessee. Day J. therefore held that the leases came to an end on their terms when production ceased in 1992.

3. Comments

This decision applies in Ontario what is already established law in Alberta, that a lessee must continue to produce in the secondary term of a lease without interruption for more than ninety days and that failure to do so will not entitle the lessee to rely on the default provision in the lease.

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6 (1995), 33 Alta. L.R. (3d) 407 (Q.B.).

D. *TRACHUK* v. *OLINEK*[7]

This case involves the competing claims to a bag of money found buried next to an oilwell site. The two parties who claimed an interest in the money were the finders and a farmer who leased the quarter section on which the oil well was situated for the purposes of grazing his cattle.

1. Facts

The plaintiff and the four defendants collectively, each claimed the right to possession of, and title to, $75,960 which was uncovered from under the surface of a quarter section of farmland near Two Hills, Alberta on May 6, 1992, by the four defendants. The plaintiff based his claim on being an occupier of the quarter section, while the four defendants based their claim on being the finders of the money. At the relevant time, Marathon Realty Company Ltd. ("Marathon") was the registered owner of the quarter section and Amoco Canada Resources Ltd. ("Amoco") was the holder of the lessee's interest in a surface lease from Marathon. Signalta Resources Ltd. ("Signalta") was the holder of an easement registered against the title to the quarter section, granting a right-of-way to a gas well site on the premises. The plaintiff was a farmer who leased the quarter section from Marathon under three successive leases for cultivation and for grazing his cattle.

The plaintiff had constructed a fence around the well site premises in order to prevent his cattle from grazing too close to the well site. Amoco reimbursed him for his labour in building the fence. The plaintiff rarely entered the fenced area. His lease excluded the area covered by the well site premises. In 1992, Signalta hired Olinek to disconnect its pipeline from the gas well. Olinek hired Austin, Fulkerth and Muntz as subcontractors. In the course of their operations, these four defendants discovered a package containing $75,960 in Canadian paper currency wrapped in a plastic bag and buried eighteen inches below the surface of the land. The four defendants removed the fence in order to perform the work. However, it was agreed by the parties that the money was discovered on the well site side of the fence.

2. Decision

Gallant J. held that the law of finders applies where a chattel which has been lost is found on privately owned land. However, he held that there is a distinction between a lost chattel and one which has been intentionally placed on or under private land. In this case, because the money had been deliberately hidden under privately owned land, the general rule, that the finder of lost property is entitled to it as against all the world except the real owner, did not apply.

Gallant J. then considered whether the plaintiff had the *de facto* occupancy or possession of the lands where the money was uncovered. He held that possession requires the intent and ability to control the use of land and exclude others from it and

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[7] (1995), 36 Alta. L.R. (3d) 225 (Q.B.).

particularly requires the intention to exclude visitors from articles on or under the land. He held that the evidence did not support Trachuk's contention that he was in *de facto* control of that portion of the lands. He had erected a fence around the well site premises with the intention of keeping his livestock out of that area and appears seldom to have entered it. Also, the agricultural use leases and the grant of exclusive possession under the surface lease, granted the oil companies the exclusive right to excavate, drill and work in the land on the well site premises. Therefore, he held that Trachuk did not show that he had a "scintilla of dominion to exercise over the portion of lands where the money was uncovered."[8]

As a result, Gallant held that the four defendants as finders had a superior possessory title to Trachuk who was a non-occupier of the well site premises.

3. Comments

Neither Marathon, the owner of the land, Amoco, the holder of the surface lease on the property, nor the other gas companies involved made a claim to the money. On the finding of Gallant J. that the occupier is entitled to money which has been deliberately placed on privately owned property, it appears that the holder of the surface lease, as the occupier of the well site premises, would likely have had a better claim to the recovered money than the four defendants who found it. This point may be of interest to oil and gas lawyers when buried treasure is found under land occupied by the holder of a surface lease.

E. *PADDON-HUGHES DEVELOPMENT CO.* v. *PANCONTINENTAL OIL LTD.*[9]

The issue in this case was whether delay rental payments which had been sent in the mail had been made in sufficient time to extend the lease.

1. Facts

The defendant had entered into two oil and gas leases (the "Thatcher Lease" and the "Bishops Lease," respectively) which provided that the leases would expire within one year if drilling had not commenced, unless it paid delay rentals before the anniversary date. The defendant claimed it had made all of the delay rental payments prior to the anniversary dates by mailing the payments to the owner and the depository respectively. These payments were received by the owner and the depository after the anniversary date had passed in the first year. They were received prior to the anniversary date in all subsequent years. The defendant eventually drilled on the lands. The plaintiff subsequently acquired title to the lands and an assignment of the defendant's leases. It sued the defendant for the value of the production from the lands after the first anniversary date. Also at issue was the status of a pooling arrangement that involved the two leases in question and another lease which would have expired in 1989 unless it was properly pooled with the first two leases.

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8 *Ibid.* at 243.

9 [1995] 10 W.W.R. 656 (Alta. Q.B.)

In the case of the Thatcher Lease, the first delay rental was due August 20, 1985. A cheque dated August 9, 1985 was sent by ordinary mail to Mr. Thatcher in California. A copy of the transmittal letter was received back by the defendant on September 9, 1985. At the bottom, under the "received and acknowledged" panel, there was a signature above the typed name, Harriman Thatcher, and the date, September 4, 1985. The cheque was endorsed "Harriman Thatcher" and bore a deposit stamp of "Sept 06 '85."

The delay rental was paid on the Bishop Lease by way of a cheque sent by mail to Toronto-Dominion Bank, as depository. The first delay rental was due August 17, 1985. The cheque request form, cheque and transmittal letter were each dated August 9, 1985. A copy of the transmittal letter was sent back by the depository. At the bottom, under the "received and acknowledged" panel, there was a signature after the name and address of the depository and the date, August 26, 1985.

In each case, it was not clear when the letters enclosing the cheques for the Thatcher Lease and the Bishop Lease were actually mailed.

2. Decision

Chrumka J. held that the leases continued. The question of onus was central to the decision. The plaintiff submitted that the burden of proof to establish the validity of the Thatcher Lease and the Bishop Lease was on the defendant because it held an option and had to show it complied with the conditions necessary to exercise the option. The defendant submitted the onus of proof was on the plaintiff to prove the negative it alleged in the pleadings: that the defendant failed to make delay rental payments prior to the anniversary date and therefore the leases expired on their own terms. The trial judge agreed with the defendant that the onus of proof was upon the plaintiff.

The lease provided that the defendant had the option, if it paid by cheque, to deliver the cheque to the Bishops or to their depository, or to mail the cheque to the Bishops or their depository. If the delay rental payment was made by mail, then the Bishops were deemed to have received the delay rental payment as of the date of mailing under the manner of payment clause in the lease.

The effective date for delivery by mail had been deleted from the Thatcher Lease. In particular, the effective date before delivery by mail had been deleted. A number of authorities were reviewed concerning manner of payment and delivery by mail. Based on these cases and the facts surrounding the Thatcher Lease, Chrumka J. found that the parties contemplated and intended that delay rental payments would be paid through the mail. Since the parties contemplated and intended that the cheque in payment of the delay rentals be mailed, "the date of mailing was the relevant date and not the date of receipt."

The evidence was wholly circumstantial and there was no direct evidence from any witness who remembered mailing the cheques for the first delay rental payments on either the Thatcher Lease or the Bishop Lease in 1995. The trial judge held that the delay rental payments were made on time within the terms of the Thatcher Lease and Bishop Lease after considering the defendant's system for mailing delay rental cheques, the defendant's mail procedures and the fact that no complaint about a late payment had been made at the time.

3. Comments

The case is perhaps most interesting for the Court's finding on the onus of proof. The decision has been appealed.

F. *FARM CREDIT CORP.* v. *KERR*[10]

The principal issue in this case is whether an interest in a surface lease is an interest in land. This issue arises in the context of a dispute between a mortgagee and the assignees of the mortgagors concerning entitlement to the proceeds arising from surface leases on the mortgaged property.

1. Facts

The defendant mortgaged four quarter sections of land to the plaintiff Farm Credit Corporation. The Farm Credit mortgage was registered subject to five caveats which were filed in the Land Titles Office to protect four surface rights leases. Farm Credit did not obtain assignments of the interests in the surface leases. The mortgage went into default in 1990 and Farm Credit served notices of intention under the Saskatchewan *Farm Security Act*[11] on November 28, 1991. On March 9, 1992, the defendants assigned all their interest in the surface leases to their wives. The dispute between the parties centred on whether Farm Credit or the wives of the defendants were entitled to the proceeds from the four surface rights leases.

2. Decision

Barclay J. began his analysis with a consideration of the question of whether an interest in a surface lease is an interest in land sufficient to sustain a caveat under the land titles system. He noted that the reversionary interest under the surface lease reverts to the owner/occupant and that a reversionary interest is an interest in land. He relied upon the decision of the Registrar of the North Alberta Land Registration District in *Drabble* v. *Alberta*[12] which held that an interest in a surface lease was an interest in land. He also noted that an analogy could be made to a lessor's royalty under an oil and gas lease where the reversionary right to the lessee's *profit à prendre* has been held to be an interest in land. He also held that a surface lease is a true lease and not merely a licence to enter and that since a lease is a chattel real it is an interest in land. Therefore he concluded that a surface lease is an interest in land and may be caveated in the Land Titles Registry.

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10 (21 December 1995), Weyburn 121/92 (Sask. Q.B.).

11 R.S.S. 1978, c. F-9.

12 (1995), 26 Alta. L.R. (3d) 410 (Q.B.).

On the question of who was entitled to the proceeds from the surface leases, he noted that the defendants had mortgaged their entire estate and interest in the land to Farm Credit, including the surface leases. Farm Credit acquired its interest in the lease through the mortgage. He held that the wives of the defendants could not acquire a greater right than the defendants to the proceeds from the surface leases and therefore that they took their assignments subject to the Farm Credit mortgage.

The mortgage provided that Farm Credit had the right to distrain for rent should the mortgage go into default. Farm Credit had the right to distrain as it owned the right to reversion of the surface leases, subject only to the mortgagor's right to redeem. Barclay J. held that since Farm Credit had given the required notice under the provisions of the Saskatchewan *Farm Security Act*[13] and *The Farm Debt Review Act*[14] it was entitled to any and all surface rights payments from the date of service. He therefore ordered the petroleum companies to pay to Farm Credit all rents due from the date of those notices.

3. Comments

This case is interesting for its conclusion that a surface lease is an interest in land sufficient to support a caveat.

III. ROYALTY AGREEMENTS

A. *BARRETT* v. *KREBS*[15]

In this case the Alberta Court of Appeal decided to deny leave to appeal to plaintiffs who were seeking to have the court reconsider the decision in *Guaranty Trust Co. of Canada* v. *Hetherington.*[16] That case determined that the requirement under clause 25 of gross royal trust agreements drafted using the PTC1 model that an owner reserve a new 12½ percent gross royalty to the trustee in any new lease when the original lease is "cancelled" does not apply to leases which expire in accordance with their terms.

1. Facts

The plaintiffs held gross royalty trust certificates. The gross royalty trust certificates were created under a gross royalty agreement that followed a model adopted by the Prudential Trust Company and commonly referred to as "PTC1." Clause 25 of PTC1 imposes an obligation on the defendant owner of the minerals, who has received a royalty under a mineral lease, to reserve a 12½ percent gross royalty to the trustee in any new lease when the original lease is "cancelled":

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13 *Supra* note 11 at 7.

14 R.S.C. 1985, c. F-2.3.

15 [1995] 10 W.W.R. 640 (Alta. C.A.) [hereinafter *Barrett*].

16 (1987), 50 Alta. L.R. (2d) 193 (Q.B.), aff'd (1989), 67 Alta. L.R. (2d) 290 (C.A.) [hereinafter *Hetherington*].

> 25. The Owner hereby covenants and agrees with the Trustee that, in the event that any lease that may be in existence as at the date of this agreement is cancelled for any reason or in the event that no lease is in existence as at the date of this Trust Agreement, he shall and will in negotiating any lease or other instrument for developing the said lands reserve into the Trustee the full 12½ percent Gross Royalty hereby assigned to the Trustee.

The original lease that existed when the owner created the gross royalty trust was not cancelled, but expired in accordance with its terms. The plaintiffs sued for a declaration that the trust agreement was applicable to the production under a subsequent lease. In dismissing the plaintiffs' legal action, the trial judge, Hunt J. applied the reasoning of the Court of Appeal in *Hetherington* and found that clause 25 did not apply as the original lease had not been "cancelled." The plaintiffs appealed, requesting that the Court reconsider the legal rule adopted in *Hetherington.*

2. Decision

The Court held that although it was not bound by its earlier decisions, the power to revise an earlier decision is one which the Court is loath to exercise except in an extreme and exceptional case where the application of the old rule would work a manifest injustice. Such circumstances did not exist in the present case.

The Court in *Hetherington* distinguished between termination by expiry and termination by cancellation. The distinction between cancellation and expiry was that cancellation was a voluntary choice by the owner whereas expiry was based upon events not involving choice. Although there was no evidence that anyone had drafted new royalty trust agreements incorporating clause 25 in reliance on *Hetherington,* the evidence disclosed that a large number of royalty trust claims in the province had been settled as a result of *Hetherington.* To reverse the previous decision and thereby undermine the large number of settled cases would bring the administration of justice into disrepute.

The Court noted that in the trial decision Hunt J. had expressed dissatisfaction with the *Hetherington* reasoning. In particular, she noted from her examination of the PTC1 lease that, in all parts of the lease except clause 25, the word "termination" was used rather than the word "cancel." She expressed puzzlement as to how the term "cancel" in clause 25, could be given the same meaning as "termination" which is used elsewhere in the lease. She noted that the Court of Appeal did not have the original lease in front of it when it rendered the *Hetherington* decision.

The Court commented that the issue is a difficult one and while some would agree with Hunt J., others would agree with the Court of Appeal in *Hetherington.* The Court also noted that although the original lease had been lost in *Hetherington,* the lease was in a standard form which was before the Court both at trial and appeal. The Court held that the distinction between termination by an overt act and termination by the natural and normal operation of a term in the lease is comprehensible and that it can be fairly argued that the trust was not to apply to entirely new leases after the term of the existing lease but only to leases made because the owner or the lessee found a way to "cancel" the old lease prematurely.

The Court held that this was not an issue respecting which it could be said that the Court in *Hetherington* made a clear error or that the error caused a clear injustice. Therefore leave was denied.

3. Comments

The carefully considered decision to deny leave in this case appears to put an end to the question of the proper interpretation of the term "cancelled" in clause 25 of gross royalty trust agreements drafted using the PTC1 model. Leave to appeal to the Supreme Court of Canada on the *Hetherington* case was denied in 1989 and the Alberta Court of Appeal has signalled its unwillingness to reconsider a decision which has been relied on by a number of parties in the intervening years.

B. *SCURRY-RAINBOW OIL LTD.* v. *KASHA*[17]

This case is another in the line of cases which have considered the nature of the interest assigned by fee simple mineral owners under form of gross royalty trust agreement. Again the issue was whether the defendant owner was under an obligation to reserve a royalty to the trustee under a new lease. The case reaches the opposite conclusion to *Barrett*[18] and is clearly distinguishable from that case on the wording of clause 2 imposing the obligation on the owner.

1. Facts

Chester Frank Kasha, being the registered owner in fee simple of all oil, petroleum, natural gas and related hydrocarbons in a certain quartersection in Alberta granted a petroleum and natural gas lease in April, 1948 to the California Standard Company for a primary term of ten years (the "Lease"). Under the terms of the Lease, California Standard agreed to pay Kasha a royalty of 12½ percent. The Lease did not give Kasha the right to take delivery in kind, nor was the royalty expressed as being "reserved." In October 1951 while the Lease was current, Kasha created the Chester Frank Kasha Gross Royalty Trust and assigned a royalty interest to Montreal Trust Company of Canada as trustee. For the purposes of this case, the most important provision of the royalty trust agreement was clause 2, headed "Assignment of Royalty" and divided into two segments:

> 1. The owner herein ... doth hereby grant, bargain, sell, assign, transfer and set over unto the Trustee, its successors, and assigns forever all the estate, right, title, interest, claim and demand whatsoever, both at law and in equity of the Owner ... in and to the above mentioned Twelve and One-half (12½ percent) percentum gross royalty or share of production of Petroleum, Natural Gas or Related Hydro-carbons from any well or wells that may be drilled upon the said

[17] (17 May 1996), Edmonton 9303-0767-AC (C.A.).

[18] *Supra* note 15.

> lands, or any part thereof TO HAVE AND TO HOLD the same with all and every benefit that may or can be derived from the same unto the Trustee, its successors and assigns forever subject only to the terms of this Trust Agreement ...
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> 2. In the event that the lease hereinbefore mentioned [the California Standard Lease] is cancelled, terminated or in any manner whatsoever brought to an end, the Owner agrees that the petroleum, natural gas and related hydro-carbons or any or all of them in and under the said lands shall continue to be subject to a Twelve and One-half (12½ percent) percentum gross royalty and the said Twelve and One-half (12½ percent) percentum gross royalty shall be subject in all respects to the trust herein created and it is further agreed that any Owner's royalty payable under any future lease of petroleum, natural gas or related hydro-carbons or any or all of them under the said lands shall be subject to the trust herein created and the Owner further agrees that he will not in future lease petroleum, natural gas or related hydro-carbons or any or all of them under the said lands without expressly providing for the payment of the Twelve and One-half (12½ percent) percentum Owners gross royalty of the leased substances free and clear of all charges, restrictions or covenants of any kind whatsoever.

A caveat was registered by the trustee claiming an interest in lands pursuant to the royalty trust agreement and that caveat has remained registered since. The trustee issued royalty trust certificates, some of which ended up being held by the respondent, Scurry-Rainbow Oil Ltd. ("Scurry-Rainbow"). Kasha died in 1975 and bequeathed to each of his children an undivided one-fifth interest in all his mines and minerals. Two of his children are the appellants in this case.

No production was achieved during the primary term of the Lease and it expired by its own terms in April 1958. Kasha subsequently granted three other petroleum and natural gas leases but no production was obtained during the primary term of any of them and each expired in the same manner as the Lease. In 1983, the appellants granted a petroleum and natural gas lease of their interest in the land to Penn West Petroleum Ltd., reserving a royalty calculated as a percentage of production. Production was obtained during the primary term of the lease and has continued.

Scurry-Rainbow brought proceedings on behalf of all certificate- holders seeking declarations that the royalty trust agreement conveyed an interest in land to the trustee sufficient to support the caveat and that the interest continues to bind the lands and the leased substances produced under the present lease.

Four issues were raised by the parties:

(1) Was the interest assigned by the royalty trust agreement an interest in the land sufficient to support the registration of the caveat?
(2) Was the assignment limited in time to the life of the Lease?
(3) Is the Chester Frank Kasha Gross Royalty Trust a properly constituted trust?
(4) Is the royalty trust agreement unenforceable as offending the rule against perpetuities?

2. Decision

Justice O'Leary began by noting that the appellants acquired their interest as beneficiaries under the will of their father, and since they were volunteers, rather than purchasers for value, the personal covenants contained in the royalty trust agreement continued to bind the appellants to the same extent as they would have Kasha were he still alive. He applied the two-step approach approved by the Alberta Court of Appeal in *Scurry-Rainbow Oil Ltd.* v. *Galloway Estate.*[19] The first step of the *Galloway* test is to characterize the interest retained by the lessor (over and above the fee simple interest in the reversion) to determine whether it is an interest in land and the second step is to examine the royalty trust agreement to determine if it conveyed an interest in land to the trustee.

In considering whether or not the lessor's royalty in this case should be characterized as an interest in land, O'Leary J.A. approved of the functional approach to petroleum and natural gas leases which was adopted by Hunt J. in the *Galloway* case, where she held that the characterization of a lessor's royalty should be approached bearing in mind the nature of the transaction in which it arose. He also agreed with Hunt J. that there is no impediment to classifying a lessor's royalty as a *profit à prendre*. He noted that Kasha, as the freehold owner could not grant or assign an interest greater than the interest which he held by virtue of the lease. Thus, the royalty interest assigned could not be greater than the royalty held by the owner.

Justice O'Leary held that:

> There is no reason in law or in principle why two interests, both characterized as *profit à prendre* and thus interest in land, cannot co-exist in respect of the same land at the same time, as long as they do not conflict. The *profit à prendre* granted by the traditional freehold and natural gas lease is defined and limited by the terms and conditions of the document. A royalty interest, viewed as a profit, may likewise be subject to conditions and restrictions, express or implied. Its terms may be complimentary but very different than those attached to the rights granted by the lease.
>
> The royalty interest of the lessor is derivative in that its value is dependent largely on the lessee's exercise of its right to exploit the leased substances. The lease gives the lessor the right, through the royalty, to participate in the commercial development of his own land in common with the lessee. The lessor's right is more than a mere contractual right. Moreover it is, in my opinion, more than simply a right to compensation for the use of the land (that is, the petroleum, natural gas and related hydrocarbons) pursuant to the terms of the lease. It is a right held in common with a lessee to participate in the development of the lessor's minerals, and in my opinion, an interest in land appurtenant to the lessor's reversionary interest.[20]

Having determined that the royalty contained in the Lease was an interest in land which vested in Kasha immediately upon granting the Lease, O'Leary J.A. turned to

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19 (1993), 8 Alta. L.R. (3d) 225, (Q.B.), aff'd (1994), 23 Alta. L.R. (3d) 193 (C.A.), leave to appeal to the Supreme Court of Canada denied, (1995), 26 Alta. L.R. (3d) 1 [hereinafter *Galloway*].

20 *Supra* note 17 at 19-20.

the question of whether an interest in land was granted under the royalty trust agreement. He held that the language of the royalty trust agreement was the language of conveyancing and not the language customarily used in an assignment of the benefit of a contractual right. In particular, he relied upon the fact that the royalty which was the subject of the royalty trust agreement was the same royalty as defined in the Lease and therefore Kasha intended to assign an interest co-extensive in nature and amount with the royalty interest he held under that Lease. The royalty trust agreement also provided that the lands would continue to be subject to the royalty after the Lease had ended and whether or not there was a lease in existence. This also pointed to a conveyance of a property interest rather than a present or prospective contractual benefit.

Thus, on the first issue, O'Leary J.A. concluded that the royalty under the Lease was properly characterized as a *profit à prendre* and that Kasha assigned that interest in land to the trustee under the royalty trust agreement.

O'Leary J.A. then turned to the second issue of whether the royalty survived the end of the Lease. He noted that the wording of the second segment of clause 2 of the royalty trust agreement expressed the intention of Kasha that the assigned royalty interest continue beyond the end of the Lease and was to be effective even when the standard lease "is cancelled, terminated or in any manner whatsoever brought to an end." O'Leary J.A. distinguished this wording from the wording considered in *Hetherington*[21] and *Barrett*.[22] In those cases, the royalty trust agreements referred only to the "cancellation" of the original lease. O'Leary J.A. held that, in contrast to "cancelled," a word which implies a premature end of a lease through some positive action by one of the parties, the word "terminated," indicates an intention that the royalty continue after the expiration of the Lease by passage of time. He noted that a conventional lease of land for a fixed term is commonly said to have terminated when a specified term expires. He also stated that the broad phrase "in any manner whatsoever brought to an end" was comprehensive enough to include the ending of the lease by the passage of time in accordance with its own terms. He therefore concluded that the royalty interest assigned to the trustee was not limited in time to the life of the Lease but was to remain effective and attached to the lands after its end, whether or not a further petroleum and natural gas lease existed.

Justice O'Leary held that the royalty interest was a presently existing interest at the time that the royalty trust was created and that the royalty trust agreement did not purport to assign after-acquired property but rather was an assignment of an existing and vested interest. The interest was assigned in such a manner as to secure the interest of the trustee after the expiration of the Lease and indefinitely thereafter whether or not the lands are from time to time subject to new petroleum and gas leases. He therefore held that the trust was properly constituted, and since the royalty interest was not a future interest, contingent upon the expiration of the original lease, but existed and was

21 *Supra* note 16.
22 *Supra* note 15.

fully vested in Kasha when the royalty trust agreement was executed, it did not offend the rule against perpetuities.

3. Comments

The wording, used in clause 2 of the Royalty Trust Agreement at issue in this case, imposing an obligation on the owner to reserve a royalty in the event that the initial lease was "cancelled, terminated or in any manner whatsoever brought to an end" is clearly distinguishable from the narrower use of "cancelled" alone in the leases at issue in *Hetherington* and *Barrett*. The Court rejected the argument that the trust was not properly constituted, on the basis that the royalty interest was something which might or might not come into existence after the end of the Lease. O'Leary J.A. held that, in effect, the royalty interest under any new lease was a continuation of the original royalty interest and, having made this determination, it was simple to conclude that no contingent interest was involved which would offend the rule against perpetuities.

C. *HARRIS* v. *NUGENT*[23]

This case involves an overriding royalty granted by a lessee. The contract, between the lessee and the holder of the overriding royalty, provided that the lessee would make it a condition of any sale of its interest that the successor in title provide a written and enforceable assumption of the obligations under the overriding royalty. The lessee's interest was subsequently assigned without any assumption of the obligation for the overriding royalty. The case considers the liability of the assignee of the lessee's interest to the holder of the overriding royalty. This is an important decision because it goes further than previous case law in placing liability for the overriding royalty upon the assignee.

1. Facts

In 1966, the plaintiff put together a play involving two Crown petroleum and natural gas leases. Originally, this play involved three parties: the plaintiff's employer, an oil company which owned the Crown leases ("Oil Company 1"); the oil company which was acquiring an interest in the leases ("Oil Company 2"); and the plaintiff's exploration company (the "Exploration Company"). The agreement between Oil Company 1 and Oil Company 2 reserved a royalty to Oil Company 1, provided that Oil Company 2 would acquire its interest by drilling, and provided that in the event that Oil Company 2 decided to surrender any portion of the land after earning its interest, it would give Oil Company 1 a right of first refusal. The agreement between Oil Company 2 and the Exploration Company provided that the Exploration Company would be granted a 2½ percent gross overriding royalty with respect to all leased substances produced, saved and marketed from the lands, applying only to the portion of the land in which Oil Company 2 earned or acquired an interest. Oil Company 2 agreed to make it a condition of any sale that any successor in title deliver to the

[23] (1995), 32 Alta. L.R. (3d) 126 (Q.B.).

Exploration Company a written and enforceable assumption of Oil Company 2's obligations.

Oil Company 2 never drilled on the lands and instead farmed out the right to earn a portion of its working interest to a drilling company and another portion of its working interest to the defendant. The drilling company drilled, and that well earned the interest for Oil Company 2 under its agreement with Oil Company 1. The drilling company's interest then passed through several hands and eventually found its way to the defendant. The defendant also earned his own interest in one quarter section by drilling another producing well.

Although all of the new players were aware of the agreement between the Exploration Company and Oil Company 2, none of the new players (which included the defendant) entered into a contract with the plaintiff or undertook to be responsible for his royalty as required under the original agreement. Later, Oil Company 2 forwarded a surrender notice and transferred the entire lease back to the successor of Oil Company 1, subject to the defendant's interest in the quarter section on which he had drilled.

The defendant entered into a series of discussions with the successor. He asserted that he also had interests acquired from the drilling company. Eventually, the successor recognized in a letter that the defendant had acquired 100 percent of the successor's working interest, subject to an overriding royalty in favour of the successor.

The defendant then attempted to persuade the plaintiff that the leases had been terminated (except with respect to the one quarter section) because of the surrender from Oil Company 2 back to the successor of Oil Company 1. The plaintiff sued to enforce payment, from the defendant, of the royalties payable under the original agreement between the Exploration Company and Oil Company 2.

2. Decision

MacLeod J. held that the portions of the working interest which were eventually controlled by the defendant were not affected by the assignment by Oil Company 2 to the successor pursuant to the surrender clause in the agreement between Oil Company 2 and Oil Company 1. He also held that the leases were not terminated within the meaning of the agreement between Oil Company 2 and the Exploration Company. The letter from the successor to the defendant was consistent with the recognition of an interest held by the defendant and was not a conveyance of interests to the defendant either for consideration or as a gift. Therefore, the royalty interests of the plaintiff were not terminated by reason of the actions of Oil Company 2.

Since there was no contract between the plaintiff and the defendant, the plaintiff could not rely on contract to enforce his claim. The defendant had not assumed complete liability, so could not be said to have been novated into the position of Oil Company 2 in the royalty agreement with the Exploration Company.

MacLeod J. held that there is little authority to support the contention that a gross overriding royalty created by a lessee constitutes an interest in land and is therefore enforceable against subsequent holders. He therefore rejected an argument that the plaintiff's royalty interest was enforceable as an interest in land.

MacLeod J. held, however, that the defendant was liable to the plaintiff in equity. He relied on *Canadian Long Island Petroleums Ltd.* v. *Irving Wire Products*[24] and on the following passage from *Fry on Specific Performance*, 6th ed. at 90 adopted by Martland J. in that case:

> §206. If a stranger to the contract gets possession of the subject-matter of the contract with notice of it, he is or may be liable to be made a party to an action for specific performance of the contract upon the equitable ground of his conscience being affected by the notice.[25]

MacLeod J. rejected the argument that the principles illustrated in *Long Island* case ought to be restricted to negative covenants. He was therefore of the view that the defendant was liable to the plaintiff on the ground that he had acquired his working interest with knowledge of the plaintiff's claim to a gross overriding royalty.

MacLeod J. held that, in the alternative, the plaintiff could recover in unjust enrichment on the grounds that the defendant had been enriched, the plaintiff correspondingly deprived and that there was no "juristic reason" for the enrichment.

MacLeod J. also held that although the corporate defendant was controlled by the individual defendant, there was no evidence that it was being used as a mere shell or for dishonest purposes and there were no representations that it could not meet its obligations. This was not an appropriate case to lift the corporate veil and treat the defendants as one entity for the purpose of any judgment against them. MacLeod J. granted judgment to the plaintiff against the defendants for the time periods during which each held the working interest in the lands from which production was obtained or to which it was allocated.

3. Comments

This decision is novel because a remedy is devised for the plaintiff although the plaintiff at no time stood in a contractual relationship with the defendants. MacLeod J. appears to reject the possibility that an overriding royalty granted by a lessee could be an interest in land and therefore enforceable against subsequent holders.

MacLeod J. held that since the defendant had notice of the original contract under which the royalty was granted to the plaintiff, that notice bound the conscience of the defendant. This is a significant extension of the principle in *Long Island.* In that case, the Supreme Court of Canada held that the plaintiff was entitled to specific performance of a right of refusal after the property in question had been transferred to the defendant

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24 [1974] 6 W.W.R. 385 (S.C.C.) [hereinafter *Long Island*].

25 *Ibid.* at 403.

Canadian Long Island Petroleums Ltd., who had knowledge of the right of first refusal when it purchased the property. Martland J. held that since the right of first refusal was a restrictive or negative covenant, the defendant was bound by it in equity, having acquired the property with actual knowledge of the restrictive covenant. There is significant merit to the argument of counsel for the defendant, rejected by MacLeod J, that the *Long Island* principle should be restricted to negative covenants, as has traditionally been the case. To this it might be added that in *Long Island* the reasoning adopted was the only way that the plaintiff could have obtained the properties on which it held a right of first refusal. In this case, the possibility that the plaintiff could get recourse in the form of payment of the money obligation from Oil Company 2 does not seem to have been canvassed.

This decision is of concern because it reaches the same conclusion as if the parties had been in privity of contract or if the plaintiff's gross overriding royalty had been found to be an interest in land. One might ask whether, if mere notice is sufficient to impose the burden of a positive covenant to pay, there is any purpose to the inquiry into the privity issue or whether an interest is an interest in land or merely contractual.

D. *GULF CANADA RESOURCES LTD.* v. *ULSTER PETROLEUMS LTD.*[26]

The issue in this case was whether the Alberta Court of Queen's Bench, or the Energy Resources Conservation Board ("ERCB") has the jurisdiction to determine which formation petroleum substances were being produced from, for the purposes of determining which party would be entitled to the payment of royalties.

1. Facts

The plaintiff Gulf Canada Resources Ltd. ("Gulf") had the right to a gross overriding royalty over all petroleum, natural gas and other hydrocarbons produced in the Muskeg zone or any higher zone. The defendants leased the deep rights below the Muskeg zone from the Crown and had the right to royalties in all areas below the base of the Muskeg formation.

The dispute arose over production from two wells. The first well had been producing from about November 1989. The ERCB had made a decision effective February 1, 1992, redesignating this well as producing from the Muskeg zone, such that Gulf was entitled to its gross overriding royalty on production from this well. The second well was designated in May 1992 by the ERCB as producing from the Keg River formation which lies below the Muskeg zone and thus would not be subject to the Gulf royalty. However, the ERCB had also held that an indeterminate proportion of production was being obtained from the Muskeg zone.

The plaintiff asserted that the Alberta Court of Queen's Bench has the jurisdiction to determine which zone production is coming from, while the respondents contended that this decision lies within the exclusive jurisdiction of the ERCB.

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[26] (4 April 1996), Calgary 9201-20982 (Q.B.).

2. Decision

Both parties agreed that the ERCB does not have the jurisdiction to make retroactive determinations of which zone production is coming from. That conclusion arises from s. 45 of the *Oil and Gas Conservation Act*[27] which provides that the ERCB may order that all or any part of a declaration or order be effective as of a date specified and that the date so specified may be previous to the date of the declaration or order but may not be previous to the date on which the application for the declaration or order was made to the ERCB. The Court accepted the proposition that, pursuant to this section, the ERCB has no jurisdiction to make a determination retroactive to the date on which an application is first made to it.

The resolution of the jurisdictional issue involved a consideration of two conflicting Alberta cases. In *Rabson Oil Company* v. *Shell Oil Company*,[28] the Appellate Division of the Supreme Court of Alberta upheld a decision by the Public Utilities Board ("PUB") that the PUB had the exclusive jurisdiction to decide the interpretation of a contract, pursuant to its statutory powers, even though the same contract was already the subject of an action in the Trial Division brought by one of the parties to the PUB hearing. The conflicting case is *Calgary & Edmonton Corp.* v. *British American Oil Co.*,[29] in which Smith C.J.A. held that unless the statute specifically took away the jurisdiction of the Supreme Court of Alberta as a superior court of record and granted it to the PUB to the exclusion of the Supreme Court of Alberta, then the jurisdiction remained with the Supreme Court of Alberta.

Fraser J. distinguished the *Rabson* case on the grounds that *Rabson* dealt with a situation where the entire subject matter of the dispute was within the jurisdiction of the PUB. In contrast, in this case, the claim of the plaintiff to royalties for the period prior to the ERCB decision of February 1992 was outside the jurisdiction of the ERCB because the legislation prohibits it from making retroactive determinations. This led Fraser J. to the conclusion that the Court had jurisdiction over the retroactive aspect of the plaintiff's claim.

Fraser J. then turned to the question of the jurisdiction of the Court over the prospective aspect of the plaintiff's claim. Fraser J. held that the Court had the right to determine the royalty question because of its inherent jurisdiction, notwithstanding the privative clauses in the legislation. He cited as authority *Mesa Operating Ltd. Partnership* v. *Amoco Canada Resources Ltd.*[30] That case involved a decision as to whether production from non-producing properties should be pooled according to the reserves underlying the properties which were pooled, or in the alternative, in accordance with the areas of the properties involved. No application had been made to the ERCB to resolve the dispute and Kerans J.A. noted that although it was not clear

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27 R.S.A. 1980, c. O-5.

28 (April 1953), (Alta. S.C.A.D.) [unreported] [hereinafter *Rabson*]. This case is discussed in *Calgary and Edmonton Corp.* v. *British American Oil Co.* (1963), 41 W.W.R. 413 at 420 (Alta. S.C.T.D.).

29 (1963), 40 D.L.R. (2d) 972 (Alta. S.C.A.D.).

30 (1994), 149 A.R. 187 (Alta. C.A.).

to him that the ERCB ever lost jurisdiction in the case, he did not need to fully explore that option because the parties were content to let the trial judge decide the case. The second reason for taking jurisdiction over the prospective aspect of the plaintiff's claim was the administrative efficiency of having one body make both the retroactive and prospective decision.

Therefore, Fraser J. held that the Court had jurisdiction to determine, prospectively as well as retroactively, the zone in which the oil was produced.

3. Comments

The significance of this decision is that it grants the Alberta Court of Queen's Bench concurrent jurisdiction with the ERCB to determine the source of oil or gas for the purposes of concluding which party is entitled to a royalty. It would appear that the Court has exclusive jurisdiction over any retroactive claim for royalties because of the prohibition against retroactive decisions by the ERCB. The significance of this for practitioners is that parties who wish to dispute the source of oil and gas now have two fora within which to make their claim.

This decision can be criticized for the lack of consideration it gives to the nature and purpose of the ERCB as an expert tribunal. The legislation appears to set up the ERCB as an expert tribunal with exclusive jurisdiction to determine scientific and technical questions with relation to oil and gas matters. Furthermore, the decision fails to consider whether the prohibition on retroactive determinations by the ERCB was intended to place a limit on claims by parties who do not make an application to the ERCB and thus provide incentive for making such an application at the earliest opportunity.

E. *KO-KEN MINING LTD.* v. *BRITISH COLUMBIA (ENERGY, MINES AND PETROLEUM RESOURCES)*[31]

The issue in this case was whether certain payments made by the appellant mining company were payments made towards the purchase of a mine, and thus deductible costs under the British Columbia *Mineral Resource Tax Act*,[32] or whether they were payments "in the nature of a royalty" and therefore not deductible for income under the *MRTA*. The case contains a useful summary of the definition of "royalty."

1. Facts

The appellant mining company ("Ko-Ken") worked a mine from 1984 to 1988 and in calculating its tax payable for those years deducted a number of payments it had made to a third party, XY Ltd., pursuant to a written agreement. The appellant argued that the payments were made towards the purchase of the mine property from XY Ltd. and were thus deductible costs under the *MRTA*. The commissioner assessed the

[31] (18 January 1996), Vancouver A900707 (B.C.S.C.).

[32] R.S.B.C. 1979, c. 263 [hereinafter *MRTA*].

appellant an additional $110,000 based on his conclusion that the payments were in fact payments in the nature of a royalty and therefore not deductible from income by virtue of s. 5(2)(a)(ii) of the *MRTA*.

2. Decision

Ryan J. (as she then was) considered a number of cases which define "royalty" and concluded that four elements are required:

(1) payments be made for the right to explore for, and bring into production, minerals yielded up;
(2) payments be made in money or kind;
(3) payments are periodic; and
(4) payments depend upon, and vary in amount, according to the production or use of the mining property.

Ryan J. then considered the agreement in place between Ko-Ken and XY Ltd. That agreement contained a clause which provided that "in return for the right to work the said lands," Ko-Ken shall pay the sum of $900,000, of which $100,000 was payable upon execution of the agreement. Every year thereafter Ko-Ken was to pay 10 percent of the value of the minerals recovered from the lands up to the full sum of $900,000. In the first two years of the agreement, Ko-Ken was to pay a minimum of $75,000 in the event that 10 percent of production was worth less than that sum. Ryan J. held that the minimum amount of $75,000 was an amount that the parties were able to calculate because they were dealing with a property with which they were familiar, and therefore could be precise about what quantity could be expected.

Ryan J. concluded that the payments met the criteria for a royalty. The payments were made for the right to bring into production minerals that were yielded up; the payments were in money or in kind; they were periodic; and they depended upon or varied in amount according to production of the mining property. Thus, the payments in question were a "royalty or similar payment" and could not be deducted under the *MRTA*.

3. Comments

This case is chiefly of interest because of its very clear definition of the term "royalty" after a thorough review of the authorities. The actual characterization of the payments in question as a royalty, turns largely on the facts and Ryan J.'s conclusion that the agreement between Ko-Ken and XY Ltd. created a right to work the lands rather than an outright sale.

F. *BANK OF MONTREAL* v. *DYNEX PETROLEUM LTD.*[33]

This case involved a priority dispute between a bank's security interests in producing petroleum and natural gas properties and the holders of overriding royalty and net profit interests in those properties. This preliminary application to the case considers whether overriding royalties and net profit interests can constitute interests in land. The creditor's rights aspects of this case are reviewed in Part IX.B of this article.

1. Facts

Dynex Petroleum Ltd. ("Dynex") gave the Bank of Montreal (the "Bank") various security against all of Dynex's producing petroleum and natural gas properties. After Dynex defaulted on its obligations to the Bank, the security under a floating charge debenture crystallized and a receiver was appointed by the court. The Bank issued a Statement of Claim in which it sought a declaration that the security which it held in the Dynex properties ranked in priority to the interests of overriding royalty and net profit interest holders. In the Court proceedings, the Bank made a preliminary application to determine whether overriding royalties and net profit interests constitute interests in land.

2. Decision

On the question of whether overriding royalties and net profit interests can constitute interests in land, Rooke J. concluded that a *profit à prendre*, which is the interest in land held by a lessee of an oil and gas lease, is the smallest interest in land and that no further interests in land can be carved out of it:

> As a matter of law, a lessee of an oil and gas lease (which is a *profit à prendre*), which is in itself an interest in land, obtained from a lessor (whether the Crown or freehold), cannot in law pass on an interest in land to a third party.[34]

Therefore, Rooke J. concluded that, as a matter of law, overriding royalties and net profit interests do not constitute interests in land. He went on to speculate that there may be good policy reasons for limiting interests in land to the interest held by the lessee of an oil and gas lease. He noted that within the oil and gas industry there is a proliferation of assignments in interests downstream and that if an assignment from a lessee to the first party in the chain of assignments would be an interest in land under the right documentation, then logic might indicate that every other assignment downstream would also be an interest in land. For policy reasons a line needs to be drawn somewhere.

Rooke J. noted that if the law had allowed an interest in land downstream of a *profit à prendre* then an examination of the language of the instrument would be required to

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[33] (1995), 39 Alta. L.R. (3d) 66 (Q.B.). The authors wish to thank Michael Laffin of Blain & Co. for providing them with his brief of this case as the basis for the briefs in this article.

[34] *Ibid.* at 67.

see if the intention of the parties was to create an interest in land. He cited numerous authorities for this proposition. However, he did not pursue the question of intention in this case due to his findings on the law:

> Intention is irrelevant in my findings to this moment because...even if we had the most perfectly drafted document to create such an intention, and evidence to support the intention of wanting to have an interest in land, I am convinced that it is not the law, and that there cannot be an interest in land at law, downstream from a *profit à prendre*.[35]

3. Comments

Drafters of royalty agreements have often attempted to create an agreement that results in an overriding royalty being characterized as an interest in land. Until now, although Canadian courts have not ruled out the possibility of an overriding royalty being an interest in land, they have been reluctant to conclude that a royalty carved out of a *profit à prendre* is an interest in land.

Justice Rooke's decision settles the law in this area and holds that at law, an interest in land cannot be created in respect of an overriding royalty from a lessee regardless of the wording of the royalty agreement, even if this is the express intention of the parties. This principle may also extend to negate interests in land from being created in cross-conveyance pooling agreements, unit agreements, sub-leases and other such arrangements.

IV. CONTRACTS

A. *PETRO-CAN OIL AND GAS CORPORATION* v. *WESTCOAST GAS SERVICES INC.*[36]

This decision dealt with the interpretation of the pricing provisions contained in a gas purchase contract.

1. Facts

The parties adopted a pricing formula which was based upon the benchmark of the price paid by TransCanada PipeLines Ltd. ("TCPL") to its producers. The parties chose to use the phrase "regulated average field price" rather than the statutory wording "regulated field price of gas." In one case under the contract, the price to be paid was the regulated average field price required by law to be paid by TCPL. In the second case the contract provided that, if the price was not regulated by law, it was to be the weighted average field price actually paid by TCPL to its producers.

35 *Ibid.* at 71.

36 (7 December 1995), Calgary 15152 (C.A.).

2. Decision

Fruman J. held that the provisions in the contract were clear and unambiguous and capable of an interpretation which promotes a sensible commercial result. She held that the trial judge had not erred by applying a straightforward interpretation to the contract rather than straining to fit the pricing provisions within one of TCPL's cost-of-service categories. She therefore upheld the conclusions of the trial judge. However, Fruman J. reversed the trial judge's decision to award costs on triple column 6 in order to punish the appellant for asserting an interpretation of the contract which was "forced and literal." Fruman J. held that a judge may award extra costs to punish a litigant for proceedings which are frivolous or tantamount to an abuse of process, but the interpretation asserted for this contract by the appellant did not fall into these categories.

B. *WELTY OIL AND GAS LTD.* v. *OPAL ENERGY INC.*[37]

This case considered what remedies are available to parties who acted under mistake of fact as to the oil and gas interest which was being contracted. The purchaser had agreed to pay a higher price for properties subject to an overriding royalty which was convertible at the royalty holder's option to a working interest after payout, on the understanding of both parties that the overriding royalty would not be converted. This assumption turned out to be false.

1. Facts

This case arose from an agreement under which the plaintiff would sell its interest in certain petroleum and natural gas properties to the defendant. The interest to be sold was a 2.5 percent working interest in certain petroleum producing properties, subject to an overriding royalty, convertible at the royalty holder's option to a 1.25 percent working interest after pay out. The price agreed for the properties was $480,000.

Prior to the closing of the deal, the parties came into possession of information which led them to believe that the royalty holder would not be exercising the option to convert the 2.5 percent working interest into a 1.25 percent working interest after pay out. As a result, the plaintiff vendor demanded that the defendant purchaser pay a higher price for the properties. The defendant agreed in writing to pay an additional $30,000 and to provide 25,000 shares of itself to the plaintiff as additional compensation. The additional money was to be paid over eight monthly instalments. The defendant made the additional payments for four months, but then became aware that the royalty holder had exercised the option to turn the 2.5 percent working interest into a 1.25 percent working interest and so discontinued the additional payments. The plaintiff Welty Oil and Gas brought an action to enforce the contract as amended.

[37] (22 November 1995), Calgary 9401-01367, 9401-14739 (Q.B.).

2. Decision

McBain J. held that the parties had amended the original contract on the basis that the royalty holder would not convert its interest. Subsequent to the execution of the contract, the royalty holder did in fact convert the interest to a 1.25 percent working interest. Therefore, he held that the purchase and sale agreement had been breached by the plaintiff because it did not deliver the interest agreed to be sold.

The defendant asserted that there was an oral term to the contract that if the conversion happened in the future there would be a return to the earlier price. McBain J. held that the parties had not made this an oral term of the amended contract and that the discussions which the parties had at the time were parol evidence not admissible for determining the content of the contract. He relied on the comments of Rawlins J. in *Lakewood 1986 Development Ltd Partnership* v. *Fletcher Challenge Petroleum Inc.*[38] that it is not proper to admit evidence of what a party said or did while the matter was in negotiation.

McBain J. then turned to the question of how damages were to be assessed for the breach of contract by the plaintiff vendor. He held that the appropriate measure of damages was the difference in value between what was contracted for and what was actually provided. In this case, there was no need to make an arbitrary assessment as to the value of the interest which was in fact sold, since there was evidence that the parties had previously contracted to purchase that interest at $480,000. Thus, the damages were quantified by McBain J. at $30,000 plus the 25,000 shares, both of which were the extra compensation. He therefore ordered that the plaintiff return to the defendant the four monthly payments already made and the 25,000 shares.

3. Comments

This appears to be a fairly simple case in which the parties acted under a mistake of fact as to the interest which was being contracted for. The damages were purely restitutionary in nature and were simple to calculate because the parties had previously contracted for the interest which was in fact sold.

C. *ATCOR LTD.* v. *CONTINENTAL ENERGY MARKETING LTD.*[39]

The issue in this case is what constitutes *force majeure* under a gas supply contract. The decision of the Alberta Court of Queen's Bench in this matter was discussed in the last recent judicial developments article.[40]

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38 (1994), 163 A.R. 115 (Q.B.) at 121.

39 (8 February 1996), Calgary 94-15517 (C.A.).

40 W.J. Hope-Ross & K.S. McClelland, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (1996) 34 Alta. L. Rev. 664.

1. Facts

The plaintiff had agreed to supply natural gas to the defendant for a six month period in 1992. During the term of the contract, various problems with the pipeline, which was required to deliver the natural gas, resulted in a partial curtailment of the amount of gas available to the plaintiff. The plaintiff cut back on its deliveries to the extent that they were curtailed by the problems caused by the pipeline. The plaintiff first reduced and then ceased deliveries under its uninterruptible supply contracts and thereafter reduced or ceased deliveries to the defendant under the agreement between the plaintiff and the defendant. The plaintiff did not reduce deliveries to its other supply customers on a pro rata basis or any other basis. The *force majeure* clause provided that:

> 9. Subject to the other provisions of this paragraph, if either party to this Agreement fails to observe or perform any of the covenants or obligations herein imposed upon it and such failure shall have been occasioned by, or in consequence of *force majeure*, as hereinafter defined, such failure shall be deemed to not to be a breach of such covenants or obligations.

The issue between the parties was whether the plaintiff was entitled to rely upon the *force majeure* clause in the circumstances.

2. Decision

Kerans J.A. began his discussion by stating that he was unable to agree with the trial judge that the operative word in clause 9, a "failure" of delivery was distinguishable from a contract which speaks of "inability" or "impossibility" of delivery. He also did not agree with the trial judge that it was a sufficient causal nexus for the supplier to show that the event was a triggering factor or that all that was necessary was to resume the performance of the covenants and obligations under the agreement with reasonable dispatch once the problematic condition was remedied.

Kerans J.A. held that a closer causal connection was required between the event and the non-performance of the contract and that the non-performance must be examined in the context of commercial reality. He stated the law as follows:

> A supplier need not show that the event made it impossible to carry out the contract, but it must show that the event created, in commercial terms, a real and substantial problem, one that makes performance commercially unfeasible.[41]

Kerans J.A. noted that the evidence suggested that the plaintiff had the option of covering the shortfall in gas supply by passing on the shortfall to specific buyers whose contracts explicitly permitted this. However the plaintiff chose instead to treat the defendant less favourably than other parties with whom it had more valuable long-term gas supply contracts. He also held that if non-performance could, in the circumstances, be excused by regard to trade practice, that was for the supplier to prove and that if it was not established, the case for the supplier would fail, not the case for the buyer.

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[41] *Supra* note 39 at 8.

Kerans J.A. held that the supplier, Atcor Ltd., had a duty to mitigate in any manner which was commercially viable. He stated:

> In sum, and in the absence of clearer words to the contrary, a supplier is not excused from non-performance by a *force majeure* event if the sole consequence of that event is to drive him to buy from another supplier and make a smaller profit. He is excused, however, if that solution, in all the circumstances is not reasonable.[42]

In the result, Kerans J.A. held that there was insufficient evidence available to the Court to determine the commercial viability of various means of mitigation available to the plaintiff. He therefore remitted the matter back to trial.

3. Comments

This case restricts the extremely broad reading of the *force majeure* clause provided by Deyell J. at trial. However, Kerans J.A. does not insist on a strict application of *force majeure* which would require that the intervening event make it absolutely impossible to perform the contractual obligations but rather holds that the supplier will be entitled to rely on any intervening event which makes it commercially not viable to continue performance of the contract. Nevertheless, he held that the risk of lost profits as a result of the intervening event should be borne by the supplier and not by the purchaser.

V. SURFACE RIGHTS

A. *FERGUSON* v. *RANGER OIL LTD.*[43]

This case reiterates the well established principle that evidence of compensation paid under comparable surface leases will be given the greatest weight in determining the quantum of surface rights compensation. The decision makes some interesting comments on the question of expert evidence which was hearsay and the applicability of evidence of subsequent negotiated settlements.

1. Facts

The Surface Rights Board (the "Board") had granted the operator fourteen Right of Entry Orders for well sites and access roads on lands owned or farmed by the appellant owners. Since the parties were unable to agree on compensation, that issue was referred to the Board for determination. At the hearing, the parties produced written compensation proposals based on a heads of compensation approach and led oral evidence to support these proposals. The Board, however, awarded compensation for disturbance and adverse effect based on a finding that there was a pattern of dealings in the area.

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42 *Ibid.* at 21.

43 [1995] 10 W.W.R. 362 (Alta. C.A.).

The owners appealed the awards on the ground that they had not been granted sufficient opportunity to make submissions on the approach adopted by the Board. In front of the trial judge, the owners entered the opinion evidence of an expert in surface rights appraisal who testified that there was a pattern of compensation in the area. He referred to compensation payable under sixty-six surface leases, although only twelve of those agreements were entered as exhibits. The expert was also permitted to refer to the compensation agreed to in four agreements entered into subsequent to the Right of Entry Orders at issue. The operator did not call expert evidence. The trial judge set aside the decision of the Board and varied the compensation award according to the approach suggested by the owners' expert. The operator applied for leave to appeal on four grounds.

2. Decision

Justice O'Leary granted leave to appeal on two grounds:

(1) The admissibility and weight of expert evaluation evidence based entirely on hearsay is an issue that has not been addressed in any earlier decisions of the Court in the context of compensation awards under the *Surface Rights Act*.[44] If the owners' expert opinion evidence was not accepted, the impact on the amount of compensation could be significant. The operator had a reasonable prospect of success on that issue and the issue should be settled for the benefit of the Board and those affected by its decisions.

(2) There is conflicting authority on the relevance and admissibility of subsequent negotiated settlements. The owner had a reasonable chance of success and the issue is important to those practising in the field of surface rights.

O'Leary J.A. also denied leave to appeal on two other grounds:

(1) The trial judge gave lengthy and detailed consideration to the Board's decision and decided not to follow it because the Board failed to advise the parties of the basis upon which it decided compensation. Also the Board made its award without the benefit of the evidence of the levels of compensation paid or payable under comparable leases in the pattern area. The trial judge was not required to accord deference to the decision of the Board.

(2) Given that evidence was led about compensation under a large number of comparable leases in the area, the fact that the trial judge may have ignored the compensation ordered in other earlier decisions of the Board was of little significance.

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[44] S.A. 1983, c. S-27.1.

3. Comments

The trial decision by Hembroff J. is discussed in the last recent judicial developments article.[45] This leave to appeal decision settles that appeals from the Surface Rights Board to the Court of Queen's Bench are *de novo* hearings without the requirement of much deference to the Board's decision. The evidence given at trial of compensation under comparable leases will be given greater weight than the compensation ordered by the Board in other decisions. The decision of the Court of Appeal on the question of hearsay expert evidence and evidence of subsequent negotiated settlements will be helpful to those practising in this area.

B. *NUMAC ENERGY* v. *INERTIA INVESTMENTS INC.*[46]

This case establishes that the time limits in the statute and the requirement that an appeal be filed in the correct judicial district must be strictly adhered to in any appeal from a decision of the Surface Rights Board.

1. Facts

Inertia Investments Inc. filed an appeal from the Surface Rights Board's determination of compensation. Numac Energy requested that the Court strike the appeal because Inertia filed its appeal in the wrong judicial district and it was now too late to file an appeal in the correct district.

2. Decision

Veit J., held that the court cannot relieve from the time limits established by the *Surface Rights Act*.[47] The law on this point is clear and was established by the Alberta Court of Appeal in an unreported decision: *Osborne Lakevold* v. *Dome Petroleum Ltd.*.[48] In that case the Alberta Court of Appeal held that the court has no jurisdiction to enlarge the time to file an appeal where the time is fixed by a statute which does not confer on the court the power to extend the time. Because this decision is unreported, a number of counsel and some judges are unaware of it. *T.M.L. Investments Ltd.* v. *Petro-Canada Exploration Inc.*[49] was decided without the benefit of the *Lakevold* decision and should not be followed. The *Lakevold* reasoning on extension of time applies equally to the court's jurisdiction to relieve from the obligation to file in the correct judicial district. The court has no power to relieve an appellant from the requirement to file in the judicial district where the land in question is situated.

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45 *Supra* note 40.

46 (22 March 1996), Edmonton 9603-02186 (Q.B.).

47 *Supra* note 44.

48 [1979] 4 A.U.D. 1304 (C.A.) [hereinafter *Lakevold*].

49 (1982), 45 A.R. 261 (Q.B.).

3. Comments

This decision is important because it draws attention to the Alberta Court of Appeal's unreported reasons in *Lakevold.* Appellants from a decision of the Surface Rights Board should be aware that the court does not have jurisdiction to modify or extend the time limits for starting an appeal or to modify the requirement that an appeal be filed in the judicial district where the land is located.

C. *PATRICIA BAR 4T RANCH LTD.* v. *CHEVRON CANADA RESOURCES LTD.*[50]

This case discusses and upholds the principle that the Surface Rights Board must take into consideration a pattern of comparable dealings in the area when determining surface rights compensation.

1. Facts

This was an appeal of a compensation order of the Surface Rights Board (the "Board") for access by the respondent to two drilling locations on the appellant's ranch lands. The appellant's central submission was that the Board erred by granting compensation in accordance with a pattern of dealings established with private landowners and by ignoring compensation being paid to the dominant landowner, the Eastern Irrigation District ("EID"), pursuant to a July 1993 agreement with PanCanadian Petroleum Ltd. ("PanCanadian").

2. Decision

Hart J. held that a body of case law has arisen which requires the Board to have regard for any established course or pattern of dealings in the area, and to depart from such a pattern only for very cogent reasons. However, this principle contemplates that the Board must have regard only to comparable patterns of dealing. Hart J. held that the compensation negotiated between PanCanadian and the EID for use of its lands was not comparable to a private landowner such as the appellant. The EID provided a number of other benefits to oil and gas operators including use of water supplies, streamline site inspection, document processing and the automatic issuance of rental review notices with adjustment calculations prepared and delivered by EID staff. Since the compensation negotiated with the EID was not comparable, the Board was correct to look for a pattern of dealings with private landowners in the area. The evidence in front of the Board was sufficient to establish such a pattern and its decision was consistent with this pattern. Therefore the appeal was dismissed.

3. Comments

This case upholds the principle that the Board must take into consideration a pattern of dealings in the area. It establishes that the Board is also entitled to examine the

[50] (2 February 1996), Calgary 9501-08264 (Q.B.).

pattern of dealings to determine whether the dealings are comparable to the one in question.

D. *TODD RANCH LTD.* v. *ALBERTA (SURFACE RIGHTS BOARD)*[51]

This case discusses the limits on the discretion of the Surface Rights Board in directing the provincial Treasurer to pay compensation to a land owner pursuant to s. 39 of the *Surface Rights Act*[52] when the operator has failed to pay money due under a compensation order or surface lease within thirty days.

1. Facts

The applicant, Todd Ranch Ltd. ("Todd") had a surface lease agreement with Inverness Energy Ltd. ("Inverness"). In 1992, although Inverness had not met the requirements of Alberta Environmental Protection with respect to reclamation, Inverness informed Todd that it intended to terminate the lease. The termination was not accepted by Todd and it brought an application under s. 39 of the *Surface Rights Act* seeking compensation for outstanding rent payments. Section 39 provides as follows:

> 39(1) When an operator fails to pay, within 30 days following the day on which it was due, any money under a compensation order or surface lease, the person entitled to receive the money may submit to the Board evidence of the failure.
>
> (2) When the evidence submitted is satisfactory in the opinion of the Board with respect to the failure to pay, the Board may direct the Provincial Treasurer to pay out of the General Revenue Fund the amount of money to which the person is entitled.
>
> (3) If the Provincial Treasurer pays money to a person under subsection (2), the amount paid thereby constitutes a debt owing by the operator to the Crown.

Prior to the hearing, the Chairman of the Surface Rights Board (the "Board") suggested that the parties discuss settlement of the application. Members of the Board were present at the settlement discussions and one member expressed the opinion during those discussions that Todd was taking an unreasonable position. Todd refused an offer to settle by Inverness and the hearing proceeded. The Board refused to grant relief to Todd pursuant to s. 39 and released reasons which included the following:

> The intent of the Act must surely be to give an affected landowner an avenue of recourse to payment when no other exists, and not to reward the likes of people who have apparently become entrenched in an unreasonable position on the assumption that the Provincial Treasurer will automatically be directed to pay. This appears to be the only reason for refusal to accept the Operator's offer to pay a reasonable albeit reduced amount of compensation.[53]

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[51] (1995), 170 A.R. 170 (Q.B.).
[52] *Supra* note 44.
[53] *Supra* note 51 at 174.

Todd appealed on the grounds that there was a reasonable apprehension of bias on the part of the Board and that the Board had made an error of law in the manner in which it interpreted its discretion under s. 39 of the *Surface Rights Act*.

2. Decision

The test for a reasonable apprehension of bias is that set out by the Supreme Court of Canada in *Newfoundland Telephone Co.* v. *Board of Commissioners of Public Utilities*.[54] That test is whether a reasonably informed bystander could reasonably perceive bias on the part of an adjudicator. In this case, since Board members had been present at the pre-hearing settlement and a member of the Board had stated that Todd was being unreasonable in refusing Inverness' settlement offer, and this opinion was later echoed in the decision, there was a reasonable apprehension of bias. The Board which sat through the settlement discussions was coloured by those discussions.

Kent J. held that the Board has very limited discretion under s. 39 of the *Surface Rights Act*. He approved of the comments of Justice Virtue in *OH Ranch Ltd.* v. *Alberta (Surface Rights Board)*:

> Section 39 of the Act provides a mechanism whereby the surface owner is *guaranteed* payment of the compensation to which it is entitled, whether the compensation has been fixed by an order of the Board or by the agreement of the parties themselves.[55]

Kent J. held that when the landowner meets the requirements set out in s. 39, then the Board is obliged to grant relief and does not have any overriding discretion to deny relief. She rejected the Board's argument that a board composed of lay-people cannot make the legal decisions required under s. 39 such as whether there is a valid subsisting lease. She noted that many boards consisting of lay-persons are expected to make decisions of law and that the determination of whether the lease continued or had been terminated was precisely what the Board was created to decide. She also held that the dispute between Inverness and the provincial environmental authorities about the standard of reclamation was not something that was to be decided under s. 39 and was not an issue between Todd and Inverness. That dispute should not be used to deny relief to Todd under s. 39.

The Board's decision was quashed. Todd's application was remitted to the Board with a direction that unless the Board finds that there was no lease in existence for reasons other than the reclamation issue, and if payments remain unpaid, Todd's application should be granted.

3. Comments

This case is of interest since it illustrates the strict limits on the discretion of the Board in relation to granting relief to persons entitled to compensation under a

54 (1992), 89 D.L.R. (4th) 289.

55 (1994), 148 A.R. 315 at 315 (Q.B.).

compensation order or surface lease. The Board is required to direct the provincial Treasurer to pay compensation to such persons if they meet the requirements of s. 39 of the *Surface Rights Act*.

E. *RANGER OIL LTD.* v. *HUK*[56]

This case discusses the jurisdiction of the Mediation and Arbitration Board created under the *Petroleum and Natural Gas Act*[57] in British Columbia to entertain claims for damage caused to land by geophysical exploration.

1. Facts

A landowner had applied to the Mediation and Arbitration Board (the "Board") under the *Petroleum and Natural Gas Act* to settle a matter of alleged damages to his land incurred during the course of a geophysical exploration. The exploration company challenged the jurisdiction of the Board to entertain the application. The Board concluded that it had jurisdiction but, at the request of the exploration company, it referred the matter to the court asking if it had erred in law.

The question of the Board's jurisdiction turns on two sections of the *Petroleum and Natural Gas Act*. Section 16 of the *Act* provides:

> 16(1) A person may apply to the Board for mediation and arbitration under this section where he ... is the owner of land that is entered, occupied or used [to explore for, develop or produce petroleum or natural gas], and damage to the land or suffering to the owner is caused by the entry or occupation....

The question before the Board and the court was whether this general power to mediate under s. 16 was limited by the provisions of s. 9(3):

> 9(2) A person who enters, occupies or uses land to explore for, develop or produce petroleum or natural gas or explore for, develop or use the storage reservoir is liable,
>
> (a) to pay compensation to the landowner for loss or damage caused, up to the date stated in the certificate of restoration for that land, for the entry, occupation or use...
>
> 9(3) Subsection (2)(a) does not apply in respect of geophysical exploration.

2. Decision

Wilson J. held that the specific exclusion of geophysical exploration from the general obligation to pay compensation to a landowner for loss or damage also means that the Board does not have the jurisdiction to mediate or arbitrate a claim for loss or damage

56 (26 October 1995), Dawson Creek 11047 (B.C.S.C.).

57 R.S.B.C. 1965, c. 33.

caused by the geophysical exploration. Therefore, Wilson J. held that the Board erred in finding that it had jurisdiction to mediate and arbitrate this application.

3. Comments

This case is of interest to oil and gas lawyers in British Columbia because it establishes that the Mediation and Arbitration Board under the *Petroleum and Natural Gas Act*[58] does not have jurisdiction to entertain claims for damage caused to land by geophysical exploration.

F. *ENCAL ENERGY LTD.* v. *VIENS*[59]

The issue in this case was whether the Mediation and Arbitration Board (the "Board") established under the British Columbia *Petroleum and Natural Gas Act* had committed errors of law in setting an amount of compensation for a surface rights owner.

1. Facts

This case arises out of a dispute between an operator and an owner of surface rights regarding compensation. The parties had been in negotiation for some time and then proceeded to mediation. After the mediation failed, the parties sought arbitration by the Board.

The two issues, on which the Board's determination of an appropriate quantum of compensation was appealed, were whether the Board was entitled to rely on information placed before it by one or more of its members in the absence of the parties, and whether the Board had misconstrued the evidence provided to it at the hearing.

2. Decision

As a preliminary matter, Wilson J. held that the jurisdiction of the court to hear and determine an appeal from the Board lay on any point or question of law raised before the Board. The phrase "raised before the Board" was interpreted to mean "points or questions of law implicitly or explicitly raised before the Board, or arising out of the Board's decision itself whether or not the point [or question] of law was argued at the Board hearing." Thus, Wilson J. rejected a stricter reading of the phrase "raised before the Board" which would have restricted the subject matter of an appeal to decisions by the Board on a point or question placed before it and argued at the hearing.

On the first question as to whether the Board had erred in law or exceeded its jurisdiction by drawing from its own knowledge and expertise, Wilson J. made the following assumptions:

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58 *Ibid.*

59 (9 February 1996), Dawson Creek 10780 (B.C.S.C.).

(1) information was placed before the Board, by one or more of its members, in the absence of the parties;
(2) the information was known to the member or members presenting it, and was not disclosed to the parties, or either of them, before, or at the time, the information was placed before the Board; and
(3) the information so presented was the basis for a finding, or findings, of fact upon which the decision was made.

On this point, Wilson J. held that she was bound by the decision of the British Columbia Court of Appeal in *Victoria* v. *Civic Employees Protective Association*[60] which stands as authority for the proposition that a tribunal such as the Board must reach its conclusion founded on the evidence adduced before it, in the presence of the parties, or their representatives. Therefore, she held that the Board had committed an error of law by relying on evidence which had not been adduced before it in the presence of the parties.

Wilson J. agreed with the submissions of the appellant that the Board had misapprehended the evidence of agreements between the parties. The Board had relied upon select portions of a comprehensive offer as the basis for an award. However, those offers were withdrawn at the outset of the arbitration and Wilson J. held that, absent conditions to the contrary, a comprehensive offer is only open for acceptance or rejection comprehensively. She therefore held that the Board had committed an error of law by misunderstanding the facts in front of it.

Wilson J. also held that the Board had committed an error of law by awarding costs on a per diem basis rather than in accordance with the fixed scale of costs in the rules of the Supreme Court which are referred to s. 27 of the *Petroleum and Natural Gas Act*.[61]

For all of these reasons Wilson J. quashed the decision of the Board and remitted the matter back to the Board for a rehearing under a differently constituted panel.

3. Comments

This decision is of interest to oil and gas lawyers because it helps to clarify that a board may not base its decision on evidence known only to it and not brought to the attention of the parties. In other respects, the case adopts a broad approach to what constitutes an issue of law as a grounds for appeal.

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60 (1952), 2 D.L.R. 153 (B.C.C.A.).
61 *Supra* note 57.

VI. ADMINISTRATIVE LAW

A. *ATHABASCA TRIBAL CORPORATION* v. *ALBERTA (ENERGY RESOURCES CONSERVATION BOARD)*[62]

This decision considers whether to grant leave to appeal to plaintiffs who were denied intervenor status by the ERCB on the grounds that they had not established an interest in the land.

1. Facts

The Athabasca Tribal Corporation consists of five First Nations, all of whom were signatories to a treaty dealing with certain lands in northeastern Alberta. The Tribal Corporation sought local intervenor status before the ERCB in connection with a hearing of an application by Syncrude Canada Ltd. for a variation of its licence in respect of a portion of those lands. The ERCB heard this application on its merits and then denied intervenor status on the basis that the ERCB was not satisfied that an interest in the land under the relevant legislation had been shown. The ERCB denied an application for a rehearing on the grounds that new facts were being relied on. The Athabasca Tribal Corporation sought leave to appeal from both the ERCB's original decision and the decision on the application for a rehearing.

2. Decision

The ERCB's decision did not make it clear whether it had decided that the Athabasca Tribal Corporation had failed to establish an interest in land, or that it did have an interest in land but such an interest had not been affected by the activities of Syncrude Canada Ltd., or that the Athabasca Tribal Corporation was not a true representative of any of the First Nations or their members. This problem was of a sufficiently serious nature and had a sufficient impact in terms of law that leave ought to be granted.

3. Comments

The decision of the Alberta Court of Appeal to grant leave in this case suggests that the court will require more of the ERCB when denying intervenor status than a simple statement that an interest in land has not been shown. The court appears to be looking for specific reasons as to why an intervenor has failed to establish an interest in land so that this particular reason can be scrutinized by the court. It is also clear that the court is not willing to speculate on the reasons why the ERCB may have reached a particular decision.

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[62] (1995), 30 Alta. L.R. (3d) 441 (C.A.).

B. *ROCKY MOUNTAIN ECOSYSTEM COALITION* v. *ALBERTA (ENERGY AND UTILITIES BOARD)*[63]

This case considers whether the ERCB, when considering a gas export permit application, has an obligation to reconsider the social, economic and environmental impacts of the entire gas project.

1. Facts

The appellants were intervenors who opposed gas export permit applications made by the respondents. In a hearing in front of the ERCB, the appellants had argued that the ERCB was required to hold a public hearing to consider the social, economic and environmental effects of the export permits, pursuant to a 1993 amendment to the *Energy Resources Conservation Act*.[64] That amendment reads as follows:

> 2.1 Whereby any other enactment the Board is charged with the conduct of a hearing, inquiry or other investigation in respect of a proposed energy project, it shall, in addition to any other matters it may or must consider in conducting the hearing, inquiry or investigation, give consideration to whether the project is in the public interest, having regard to the social and economic effects of the project and the effects of the project on the environment.

The ERCB determined that the amendment did not fundamentally change its mandate and that if the applications for export were made consistent with existing regulatory requirements, the social, economic and environmental impacts would already have been specifically addressed. The intervenors were granted leave to appeal this decision.

2. Decision

The Court of Appeal unanimously held that given the jurisdiction of the ERCB to exercise its continuum of supervising, controlling and approving responsibilities regarding the exploration, development, transportation, marketing and exporting of gas, the ERCB was correct to conclude that it was not reasonable to enter into a reconsideration of the social, economic and environmental effects of the export permits for the export permit stage. The Court noted that the ERCB considers the public interest including social, economic and environmental impacts at each of the multi-step process of approval regarding gas exploration, development and marketing. To reconsider these at the gas export stage would be duplicitous. Given the Court's conclusion that the export stage is not an appropriate stage for further consideration of the social, economic and environmental impact, the Court did not find it necessary to decide whether the new amendments require the ERCB to expand or alter its existing policies and approval procedures with respect to earlier stages in the approval process.

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63 (15 December 1995), Calgary 95-15818 (C.A.).

64 R.S.A. 1980, c. E-11.

3. Comments

The Court of Appeal has interpreted the 1993 amendments to the *Energy Resources Conservation Act*[65] as confirming the current ERCB practice of considering the social, economic and environmental impact of new proposed resource projects at various stages requiring approval of the ERCB but not at the export stage. The Court indicated that, although it did not decide the point, it would be unlikely to regard the amendments as placing any additional requirements on the ERCB even at the earlier stages in the approval than current ERCB practice.

C. *PACIFIC CASSIAR LTD.* v. *ALBERTA (ENERGY RESOURCES CONSERVATION BOARD)*[66]

This case considers an application for judicial review of a decision of the ERCB on the grounds that the Board had failed to consider the relevant issues and to follow its own established policies.

1. Facts

The appellant had intervened in proceedings in front of the ERCB in opposition to an application by the respondent, Chancellor Energy Resources Inc., to construct and operate a gas processing plant, as well as companion applications to construct and operate a pipeline gathering system to serve the plant and a sales gas line to handle the gas after processing. The appellant applied for judicial review of the approval of the application by the ERCB.

2. Decision

O'Leary J.A. stated that decisions of the ERCB are entitled to curial deference in matters within its jurisdiction but that the court will interfere in the case of jurisdictional error or a patently unreasonable finding of fact or law. O'Leary J.A. rejected the appellant's argument that the ERCB had failed to follow its plant proliferation policy. He noted that the ERCB considered the two critical issues relating to the application of that policy, namely the question of reserves and the question of plant capacity. He held that the ERCB's reasons were adequate and properly set out the matters which the Examiners took into account including the matters required under the plant proliferation policy. He held that the material filing requirements were within the discretion of the ERCB under Regulation 15.050(1) and therefore the ERCB's decision not to require filing of all matters was not fatal to their decision. O'Leary J.A. noted that the appellant chose not to seek a full hearing and consideration by the ERCB, as it was entitled to do under s. 36 of the *Act*.[67] Therefore, the Court dismissed the appellant's request for judicial review.

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65 *Ibid.*

66 (18 January 1996), (Alta. C.A.) [unreported].

67 *Supra* note 64.

D. *CONSUMERS' GAS CO.* v. *CANADA (NATIONAL ENERGY BOARD)*[68]

The issue in this case was whether a portion of a gas pipeline owned by Consumers' Gas Company Ltd. ("Consumers'") should be subject to federal regulatory jurisdiction as an integral part of an interprovincial pipeline owned by Niagara Gas Transmission Ltd. ("Niagara").

1. Facts

The facts in this case are simple. Consumers' is a gas distribution company which owns and operates a gas distribution system in the Ottawa area. Gazifère Inc. ("Gazifère") runs a retail distribution system of natural gas in Gatineau, Quebec. Niagara runs a pipeline which joins the Consumers' pipeline with the Gazifère distribution system and crosses the Ontario-Quebec border. All three companies, Consumers', Niagara and Gazifère, are affiliated companies with a common ownership.

There was no dispute that Consumers' and Gazifère, as intra-provincial distribution systems, had previously been regulated provincially by the Ontario Energy Board and La Regie du Gaz Naturel respectively. There was also no dispute that Niagara, as an interprovincial carrier of gas, is subject to regulation by the NEB.

In the decision under attack, the NEB applied the standard two-part test to determine whether a work or undertaking is interprovincial:

(1) was the Consumers' distribution system of itself an interprovincial work or undertaking; and

(2) if not, was it in any event subject to federal jurisdiction by reason of being an integral part of a core federal undertaking, namely the Niagara line.

The NEB was unanimous in its view that the Consumers' gas distribution system was not itself an interprovincial work or undertaking. On the second question however, the NEB, by a majority of four to two, held that the Ottawa East Line, (being that portion of the Consumers' gas distribution system which is connected to the Niagara line) is a vital, essential and integral part of the Niagara line because the Niagara Line was dependent on the many services provided by the Ottawa East Line.

2. Decision

The Federal Court of Appeal, in a decision of Hugessen J.A., was unanimously of the view that the decision of the majority of the NEB was incorrect and that the appeal must succeed for three fundamental reasons:

(1) The Ottawa East Line is, and always has been, an integral part of the Consumers' Ottawa gas distribution system and is not a separate undertaking for constitutional purposes. It is constitutionally impermissible to break into

[68] (1996), 195 N.R. 150 (Fed. C.A.).

constitute parts an undertaking whose existence as separate independent undertakings is wholly notional.

(2) The NEB's finding that the Niagara line was dependent on the Ottawa East Line was incorrect for four reasons:

(a) The Niagara Line which is "solely a transportation entity" does not need the services of heating, odourant, regulation and load balancing facilities provided by Consumers' at the point where the two pipelines interconnect;

(b) there is no constitutional significance to the fact that compression for both Consumers' and Niagara will be provided by TCPL, a federal undertaking;

(c) the commercial dependency of Niagara on those who ship, and receive, its natural gas product does not create dependency in the constitutional sense; therefore commercial arrangements between the parties with relation to the shipment of natural gas was not constitutionally relevant; and

(d) the fact that Niagara entered into contractual arrangements for the construction and operation of its line by Consumers' is not constitutionally significant and does not create a relationship of dependency.

(3) The majority of the NEB failed to consider that the portion of Consumers' undertaking which is operated for the benefit of the interprovincial Niagara Line is a relatively minor part of Consumers' overall undertaking. When an undertaking is primarily provincial and the inquiry is to determine whether such undertaking has become federal by reason of its integration with a core federal undertaking, it is not enough if the provincial undertaking's involvement in the federal undertaking is only minor in extent or casual in nature.

3. Comments

This case is a particularly significant one for oil and gas lawyers because it sets out clearly the test to be applied for determining whether a portion of pipeline is to be considered an interprovincial undertaking and rejects many of the bases relied upon by the NEB. The reader is referred to the more detailed analysis of this case and the following case provided by Roland Harrison in the article elsewhere in the Petroleum Law Edition.[69]

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69 R. Harrison, "The Interface Between Federal and Provincial Jurisdiction Over Pipelines" (1997) 35 Alta. L. Rev. 389.

E. *WESTCOAST ENERGY INC.* v. *CANADA (NATIONAL ENERGY BOARD)*[70]

The issue in this case was whether two new processing facilities which Westcoast Energy Inc. ("Westcoast") intended to bring on line are part of an interprovincial undertaking so as to bring them within the jurisdiction of the NEB.

1. Facts

Westcoast proposed to bring on line two new processing facilities in British Columbia. When a public hearing was called to consider the application for the first facility, B.C. Gas Utility Ltd. raised the question of the NEB's jurisdiction over the existing and proposed gathering and processing facilities of Westcoast. The objection to the NEB's jurisdiction was two-fold. First it was argued that the NEB had no jurisdiction over the gathering and processing facilities on constitutional grounds since the facilities were situated entirely within the limits of the Province of British Columbia. The second objection was that Westcoast's proposed processing facilities do not come within the NEB's statutory jurisdiction because they do not form part of a "pipeline" as that term is defined in s. 2 of the *National Energy Board Act*.[71] The NEB accepted these arguments and declined jurisdiction over the proposed new processing facility.

2. Decision

Hugessen J.A., writing for unanimous Federal Court of Appeal, held that the most important question was the constitutional question as to whether the proposed facilities constituted undertakings connecting the province with any other province or extending beyond the limits of the province. He noted that question gave rise to the further inquiry as to whether Westcoast is conducting one or more than one undertaking. As a starting proposition, if the processing facilities and the gathering facilities were to constitute a single undertaking, there would be no question that such an undertaking would be an interprovincial undertaking because the gathering operation extends at both its upstream and downstream ends beyond the limits of British Columbia.

Hugessen J.A. noted that the question of whether the relevant facilities of Westcoast constitute one or more than one undertaking involves an inquiry into the actual operation of Westcoast as it exists and functions. He further noted that the question cannot be answered by how the enterprise might have been structured or how other people operate and structure different enterprises.

Hugessen J.A. set out the following basic principles and discussed the case law which supports them:

(1) The simple fact that Westcoast carries out all of the various operations does not by itself make those operations into one undertaking.

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[70] (9 February 1996), A-545-95, A-606-95 (Fed. C.A.).

[71] R.S.C. 1991, c. N-7 [hereinafter *NEB Act*].

(2) However, the fact that there may be different activities or services being carried on does not prevent them from forming part of a single undertaking.

(3) It is not the difference between the activities and services which are carried on, but rather the interrelationship between them, and whether or not they have a common direction and purpose which will determine whether they form part of a single undertaking.

After considering a detailed analysis of Westcoast's gathering and processing operations, Hugessen J.A. identified the following facts which led him to the conclusion that Westcoast is engaged in a single undertaking, comprised of the business of gathering, processing and transporting natural gas:

(1) Westcoast is a provider of services only; it does not trade or deal in the gas it transports;
(2) processing is required to facilitate the transportation service provided by Westcoast;
(3) processing is offered as a service exclusively to shippers on Westcoast's mainline transmission facilities;
(4) the fuel gas which goes into Westcoast's mainline transmission facilities is, by far, the major component of the raw gas gathered and processed by Westcoast;
(5) Westcoast's facilities are not only physically interconnected and interdependent, they are, in some cases, interchangeable;
(6) fuel gas may be contractually delivered across provincial borders from all Westcoast processing plants, including those which take the raw gas supply from across provincial borders;
(7) the same personnel work on both the gathering and mainline transmission pipelines and they, together with the personnel of the processing plants, are subject to a unified central operational control and direction; and
(8) Westcoast is the owner of all the facilities in question.

Hugessen J.A. went on to note that although ownership is not, by itself, determinative of constitutional jurisdiction, ownership together with its attendant control and direction is relevant to the question of jurisdiction. Hugessen J.A. also made the following additional observations:

(1) Even the most broad and generous interpretation s. 92A of the *Constitution Act, 1867*[72] does not prevent the exercise of federal jurisdiction over a transportation undertaking which receives raw gas from the producers thereof after it has been extracted from the ground, dehydrated and transported to delivery points. Such federal jurisdiction is entirely compatible with the exercise of provincial powers over natural resources guaranteed in s. 92A.

(2) There was no merit to the argument that the gathering activities of Westcoast conducted in one part of British Columbia are a different undertaking from the

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[72] (U.K.), 30 & 31 Vict., c. 3.

identical activities conducted under a common management and direction by the same company in another part of British Columbia and which extended into other provinces. The gathering operation was a single undertaking which was interprovincial in nature.

(3) The fact that only a relatively small part of Westcoast's gathering facilities extend into other provinces is of no constitutional significance.

Hugessen J.A. also held that the proposed processing plants of Westcoast fall within the definition of "pipeline" in s. 2 of the *NEB Act* and therefore fall within the jurisdiction of the NEB.

3. Comments

This case provides a useful summary of the major points to be considered when a constitutional issue arises concerning whether an undertaking falls within provincial jurisdiction as a local work or undertaking, or whether it falls under federal jurisdiction as an interprovincial work or undertaking. The factors listed in this case as an explanation for why the court held that the processing facilities are a single integrated undertaking with the gathering facilities are a helpful guide to the relevant considerations. We direct the reader to the more detailed analysis of this case and the preceding case contained in the article by Roland Harrison.[73]

F. *SLAUENWHITE* v. *ALBERTA (ENVIRONMENTAL APPEAL BOARD)*[74]

This case considers the appropriate standard of review for decisions of the Alberta Environmental Appeal Board ("EAB") and the scope of that board's duty to review decisions of the Director of Environmental Assessment.

1. Facts

The ERCB approved a company's application for a sour gas plant following a four day public hearing which involved the consideration of an Environmental Impact Assessment ("EIA"). The terms of reference with respect to the EIA had been issued by the Director of Environmental Assessment. The Director of Standards and Approval reviewed the decision of the ERCB and issued an approval of the plant. The applicants, a group of residents in the area of the proposed gas plant, filed a Notice of Objection to the director's approval. After a preliminary meeting, the EAB dismissed the appeal. The applicants then requested that the EAB review its decision, but the EAB determined that it was *functus officio* and had no authority to review its earlier decision. The applicants applied for judicial review of the EAB's decisions to dismiss the appeal and refuse the review.

73 *Supra* note 69.

74 (1995), 33 Alta. L.R. (3d) 336 (Q.B.) [hereinafter *Slauenwhite*].

2. Decision

The EAB's decision not to review its earlier decision was based on its interpretation of the wording of s. 87(5)(b)(i) of the *Environmental Protection and Enhancement Act*.[75] Wilkins J. held that the EAB had no special expertise or knowledge which might place it in a better position than the court to interpret the words of the *EPEA* on a manner relating to its own jurisdiction. A review of the *EPEA* did not lead to the conclusion that the legislature intended that the question of jurisdiction would ultimately be decided by the EAB. Accordingly, the standard for review of the EAB's decision was correctness.

On reviewing the ERCB and EAB decisions, as well as the EIA, Wilkins J. found that no consideration had ever been given to the environmental impact of the construction of the gathering system which would deliver 40 percent of the gas capacity of the proposed plant to the site of the plant. That deficiency could not be answered by future applications before the ERCB, since any such application would likely be biased in favour of approval once the plant was constructed. The failure to consider the environmental impact flowing from full utilization of the proposed plant prior to approving its development was a fundamental breach of the duty imposed on the director to review the application prior to issuing an approval. The director's (defined by Wilkins J. as the Director of Environmental Assessment) failure to undertake the review was a matter properly before the EAB and it was patently unreasonable for the EAB to conclude that the *EPEA* prevented it from determining whether or not the environmental impact of the whole project had been weighed in accordance with the *Act* and regulations.

Wilkins J. also held that the EAB was incorrect to suggest that citizens opposed to developments had an onus to oppose or cross-examine the director or the department at ERCB hearings or to gather evidence themselves. A failure to do these things should not result in citizens losing grounds for appeal before the EAB. The director's performance of his or her duty was properly reviewable by the EAB and any deficiencies in the review of all the environmental impacts rested upon the director.

The Court held that the EAB was incorrect to conclude that s. 87(5)(b)(i) of the *EPEA* prevented it from holding a hearing of the objection. That decision was therefore quashed. The Notice of Objection was returned to the EAB for consideration in accordance with the *EPEA*.

3. Comments

This case is important because it establishes that the EAB will not be granted deference in matters relating to its own jurisdiction. The case also stands as authority for the proposition that the EAB has the responsibility to scrutinize whether the Director of Environmental Assessment properly undertook a review of the environmental impacts of new developments according to the *Act* and regulations.

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[75] R.S.A. 1992, c. E-13.3 [hereinafter *EPEA*].

There is one fundamental problem with this decision which is an apparent confusion of the Director of Standards and Approval with the Director of Environmental Assessment and their respective responsibilities under the *EPEA*. The Court defined the term "Director" which is used for the balance of the decision, by reference to the Director of Environmental Assessment. It is that director's responsibilities which are discussed in the decision. However, the impugned decision from which the appeal was taken to the EAB was that of the Director of Standards and Approvals. Given this problem, it is difficult to know what precedential value the case will have.

G. *BOW VALLEY NATURALISTS SOCIETY* v. *ALBERTA (MINISTER OF ENVIRONMENTAL PROTECTION)* [76]

This case considers the appropriate standard for judicial review of decisions of the Director of Environmental Assessment. It also considers the correct definition of the phrase "mandatory activity" as found in s. 42(1) of the *EPEA* [77] and the proper exercise of the director's discretion to order an EIA.

1. Facts

The respondent BHB Canmore Ltd. ("BHB") is a developer which had plans to build a resort in the Dead Man's Flats area near Canmore, Alberta. The site was bordered by three designated natural areas, although at the time the original plans were submitted only one of the areas had been designated. The region was also known to be an important north-south wildlife corridor. In 1991, BHB was ordered to prepare an EIA pursuant to the *Land Surface Conservation and Reclamation Act*.[78]

Subsequently, BHB presented a new proposal based on a redesign of part of the project. Also, the *EPEA* was newly proclaimed in force to deal with environmental concerns in the province. The *EPEA* provides for an EIA to be submitted where necessary.

The appellant environmental groups submitted a detailed commentary on the redesigned development and requested that an EIA be performed. The Director of Environmental Assessment (the "Director") subsequently informed BHB that no EIA would be required for the proposed project pursuant to s. 41(1) of the *EPEA*.[79] The appellants applied for judicial review of the Director's decision.

2. Decision

Kenny J. held that although an EIA had been ordered under the *LSCR Act*, the National Resources Conservation Board ("NRCB") was not seized with a review of the development. The transitional sections of the *EPEA* only put a review of the proposed

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76 (1995), 35 Alta L.R. (3d) 285 (Q.B.).

77 *Ibid.*

78 R.S.A. 1980, c. L-3, as rep. by *EPEA*, *supra* note 75, s. 247 [hereinafter *LSCR Act*].

79 *Supra* note 75.

project under the scrutiny of the NRCB where an EIA report had been prepared and submitted to the minister. Since the report in this case had not been submitted to the minister, the NRCB was not seized of the matter. Kenny J. also rejected the appellants' argument that they were entitled to the protection of a legitimate expectation that concerns about the proposed resort would be considered by the NRCB. Kenny J. noted that the appellants did have the opportunity to make written submissions about the proposed project, but that since the NRCB was not seized of the matter, they could not have legitimate expectations of appearing before that body.

Kenny J. carefully considered the standard for judicial review of decisions of the director. She referred to the decision in *Slauenwhite*[80] in which Wilkins J. had noted that there is no privative clause limiting judicial review of the ERCB. Wilkins J. held that despite the lack of a "built-in" statutory limit such as a privative clause, there is a strong tradition of courts showing curial deference to administrative bodies which possess a high degree of expertise. She concluded that the court is entitled to review only those matters which lay outside the director's area of expertise, unless a decision within that area was patently unreasonable or the director acted unreasonably in evaluating the evidence to reach his decision.

Kenny J. then turned to the question of whether the proposed resort was the sort of project for which an EIA is mandatory. This decision turned on the interpretation of s. 42(1) of the *EPEA*:[81]

> 42(1) where a proponent or a proposed activity is referred to the Director . . . the Director shall,
>
> (a) if the proposed activity is a mandatory activity, direct the proponent by order in writing to prepare and submit an environmental impact assessment report in accordance with this Division, or
>
> (b) if the proposed activity is not a mandatory activity,
>
> (i) ensure that further assessment of the proposed activity is undertaken where the Director is of the opinion that the potential environmental impacts of the proposed activity warrant further consideration under the Environmental Assessment Process, or
>
> (ii) make a decision that further assessment of the proposed activity is not required and, if it is an activity for which an approval is required, advise the proponent that it may apply for the approval.

Kenny J. first considered whether the proposed resort fell within s. 42(1)(a), as a "mandatory activity." "Mandatory activity" is defined as:

80 *Supra* note 74.

81 *Supra* note 75.

> [A] tourism facility that is expected to attract more than 250,000 visitors per year and will be immediately adjacent to an ecological reserve, a natural area or a wilderness area under the *Wilderness Areas, Ecological Reserves and Natural Areas Act*.[82]

After reviewing the evidence, Kenny J. held that the 250,000 persons-per-year threshold would easily be met by the proposed resort. She also held that the court should not adopt a legalistic and narrow interpretation of the phrase "immediately adjacent." She stated that "a liberal assessment of environmental concerns in this case requires that the objectives of environmental protection statutes and the adoption of a construction which considers the cumulative effects of development in environmentally sensitive areas be followed." She noted that in addition to one adjacent area which had already received official "natural area" status, another area had received protective notation status, a strong indicator that official "natural area" status would soon be conferred.

Thus, Kenny J. held that the two requirements for a mandatory activity were met: 250,000 visitors and immediately adjacent to two natural areas. She therefore concluded that the director was incorrect not to order an EIA under s. 42(1)(a) of the *EPEA*. However, she held that the standard for review for this issue, because it fell within the jurisdiction of the director is "patently unreasonable." She held that the director's decision, although incorrect was not patently unreasonable and thus could not be overturned on this point.

Kenny J. then considered whether the director ought to have ordered an EIA under s. 42(1)(b)(i) of the *EPEA*, which requires the director to ensure that further assessment of the proposed activity is undertaken where the director is of the opinion that the potential environmental impacts of the proposed activity warrant further consideration. Kenny J. referred to the statements of concern submitted by the appellants to the director which particularly highlighted the north-south wildlife corridor in the area. She was particulary impressed by the fact that the government's own experts concurred in an internal screening report with the concerns expressed by the appellants. The director did not receive any evidence to contradict the concerns raised by the appellants for the internal report.

Kenny J. held that the Director committed an error of law in coming to the conclusion that no EIA was required in the total absence of information to counter that adduced by the appellants and the government experts. She held that it was patently unreasonable for the director to conclude as he did in the face of the uncontradicted evidence which he possessed. As a result, Kenny J. granted the application and ordered an EIA to be done pursuant to s. 42(1) of the *EPEA*.

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82 Alta. Reg. 111/93; *Wilderness Areas, Ecological Reserves and Natural Areas Act*, R.S.A. 1980, c. W-8.

3. Comments

Although not an oil and gas case, this case is very significant with relation to EIAs. The case establishes that the decision of the Director of Environmental Assessment with respect to EIAs will be entitled to curial deference to the standard of patent unreasonableness. However, the court recognizes the need to encourage the liberal assessment of environmental concerns and appears to have been relatively willing to find patent unreasonableness in the director's decision.

If this decision can be criticized, it is not because EIA was ordered, but rather for the manner in which Kenny J. reached that conclusion. Paragraph 42(1)(a) of the *EPEA* requires that an EIA be prepared if the proposed activity is a "mandatory activity." Kenny J. found that the proposed resort project met the two requirements for a mandatory activity. Arguably, this finding is a finding of law, and Kenny J. specifically held that the director would be subject to review on a correctness standard in matters of law. Given that s. 42(1)(a) does not contain any words granting a discretion to the director, but requires him to order an EIA where the activity is a "mandatory activity," it is difficult to understand why Kenny J. allowed the director the benefit of a standard of patent unreasonableness, which would be more appropriate where the matter was one on which he was entitled to exercise discretion.

Subparagraph 42(1)(b)(i), on the other hand grants the director a very broad discretion personal to the Director in the words "where the Director is of the opinion." Kenny J. holds that the discretion granted to the director in this section does not entitle him to reject concerns expressed by intervenors or by the internal experts in his department when reaching his decision under s. 42(1)(b)(i), unless he is presented with other contradictory evidence. With respect, to characterize the director's decision under this section as patently unreasonable grants the director relatively narrow discretion.

H. *KOOPMAN* v. *OSTERGAARD*[83]

This case is to be read in conjunction with the two *Chetwynd* cases which follow. All three cases arise from an application by Imperial Oil Resources Ltd. ("Imperial Oil") for the necessary authorizations and licences to drill an exploratory natural gas well in British Columbia. The *Koopman* case upholds the decision of the Ministry of Energy to grant a Well Authorization but quashes the decision of the Ministry of Forests to grant a Licence to Cut which was necessary for the construction of the access road to the well site. The Ministry of Forests subsequently granted another Licence to Cut. The first *Chetwynd*[84] case considers whether an environmental group had standing to seek an interim injunction against further construction of the access road until a decision was made on the validity on the second Licence to Cut. The second *Chetwynd*[85] case considers whether the Ministry of Forests applied the correct test in granting the second Licence to Cut.

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83 (1995), 12 B.C.L.R. (3d) 154 (S.C.) [hereinafter *Koopman*].

84 *Infra* note 90.

85 *Infra* note 94.

1. Facts

Imperial Oil Resources Ltd. applied for and was granted a Well Authorization under s. 97 of the British Columbia *Petroleum and Natural Gas Act*[86] and a Licence to Cut Crown timber under s. 47 of the British Columbia *Forest Act*[87] in connection with the drilling of a exploratory well for natural gas in the Belcourt area of British Columbia Imperial Oil proposed to construct a twenty-five-kilometre road over Crown land to access the well site.

The application was reviewed by the Energy Resources Division, Ministry of Energy, Mines and Petroleum Resources ("Energy"). In the course of the review, the application was referred to both the Ministry of Forests ("Forests") and the Ministry of Environment, Lands and Parks ("Environment"). Forests objected that the well site and associated access would convert the area from primitive to motorized recreation and result in permanent disturbance to the alpine and sub-alpine area. Environment objected to the impact on water quality and fisheries values and loss of alpine habitat. Forests recommended that Imperial Oil utilize a heliportable rig for drilling.

In May 1995 Energy granted the Well Authorization, permitting Imperial Oil to construct the well site, campsite and access road. In June 1995 Forests issued a Licence to Cut timber in connection with the building of the access road. An official in Forests explained to the petitioner that Forests had to issue the Licence to Cut because Energy had approved the Well Authorization, including road access.

The petitioner applied for relief under the *Judicial Review Procedure Act*[88] in relation to both the Well Authorization granted by Energy and the Licence to Cut granted by Forests. An interim injunction was granted restraining Imperial Oil from road construction activities beyond a certain point.

2. Decision

Justice Allen of the Supreme Court of British Columbia upheld the Well Authorization issued by Energy but quashed the Licence to Cut issued by Forests.

In explaining the role of the court on judicial review, Justice Allen established the following principles of law governing judicial review:

(1) the court is obliged to determine whether the decision maker acted within the bounds of the jurisdiction conferred by the empowering statute;
(2) if so, the court will only intervene if the decision was "wrong in law" or "patently unreasonable";

86 R.S.B.C. 1979, c. 323 [hereinafter *PNGA*].
87 R.S.B.C. 1979, c. 140.
88 R.S.B.C. 1979, c. 209.

(3) a patently unreasonable decision may result because the administrative decision maker failed to take into account a highly relevant consideration or improperly took into account an extraneous consideration;
(4) the court must accord the appropriate deference to discretionary decisions made by administrative bodies acting under statutory authority; and
(5) the court's role is to consider the legality of the decision, not its correctness or wisdom.

On the question of whether there was a proper exercise of discretion, it was held that the Energy official had taken into consideration the concerns of Forests and Environment, mitigating measures, the economic benefits to the province created by the petroleum and gas industry, and the conditions imposed by Energy in the Well Authorization. He considered the heliportable drilling as an alternative to road access but accepted Imperial Oil's concerns that helicopter-supported drilling raised unacceptably high safety and operational risks. He did not specifically take into account the *Forest Practices Code of British Columbia Act*[89] which had not been enacted at the time. It was held that had he have taken such principles into account, he would have also been entitled to note that a Well Authorization is a permitted use of Crown land under the regulations to the *Code*. In exercising his discretion, the Energy official took into account the environmental concerns by placing specific conditions and restrictions on the Well Authorization and weighed them together with other policy considerations such as economic and social concerns. Therefore, the decision to grant the Well Authorization was not "patently unreasonable."

With respect to the Licence to Cut, it was held that the Forests official failed to act within his statutory mandate to make decisions based upon relevant factors under the applicable legislation. He had fettered his discretion as a result of his misapprehension that he was compelled to issue the Licence to Cut in view of Energy's approval of the Well Authorization. This in spite of his own concerns and the objections of Forests. The Licence to Cut was quashed.

3. Comments

This case, and the two which follow, demonstrate the problems an oil company can encounter with inter-governmental reviews of projects and the need to co-ordinate responses and plans. There is the potential for environmental groups to apply for judicial review of each aspect of governmental approvals relating to a project. The significance of this decision lies particularly in its discussion of the factors which were relevant to the valid issuance of the Well Authorization. The decision is also significant because it establishes that a ministry with a lesser role to play in the overall licensing scheme cannot fetter its discretion by relying solely on the decision of the ministry with the larger role. Each ministry must give independent consideration to the question of whether to issue the licence or authorization which lies within its jurisdiction. This case should be read in conjunction with the second *Chetwynd* case which follows.

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89 S.B.C. 1994, c. 41 [hereinafter *Code*].

I. *CHETWYND ENVIRONMENTAL SOCIETY* v. *BRITISH COLUMBIA (MINISTRY OF FORESTS, DAWSON CREEK FOREST DISTRICT)*[90]

This case considers whether an environmental group had the standing to seek an interim injunction to prevent continued construction of an access road by Imperial Oil. The case is to be read in conjunction with both the preceding and following cases.

1. Facts

This application was brought by the petitioners for a stay or interim injunction in respect of the road-building permits that were granted to Imperial Oil in connection with the Well Authorization that was the subject of the decision in *Koopman*[91] after the Licence to Cut was quashed. Imperial Oil applied for a new one and on September 15, 1995, the respondent Dyer of Forests issued a new Licence to Cut. The petitioners sought a stay of this permit and of the Temporary Crown Land Use Permit issued by Environment or alternatively, an interim injunction restraining Imperial from doing any and all timber harvesting and road construction activities pending the hearing of a petition, to have the permits quashed.

Imperial Oil opposed the applications and raised a preliminary objection that the petitioners should not be granted standing to bring the action and the action should be struck.

2. Decision

The petitioners applied for public interest status to bring the action. To be granted such status they had to meet the test in *Canadian Council of Churches* v. *Canada (Minister of Employment and Immigration)*[92] and show that there was a serious and justiciable issue raised, that they had a genuine interest in the issue, and that there was no other reasonably effective manner in which the issue could be brought before the court. Prowse J. held that these requirements were satisfied and granted them public interest status.

The claim made by the petitioners that the land use permit and the timber permit were unlawfully issued because Environment and Forests had failed to make independent decisions under the mistaken belief that their discretion in issuing the permits was restricted once the Well Authorization had been issued by Energy raised serious and justiciable issues. As for the second part of the test, it was held that as non-profit societies they did have a genuine interest in the issue in the case of the Chetwynd Environmental Society for promoting environmental protection and education in the Northern Rockies Region and, in the case of the Canadian Parks and Wilderness Society for having the purpose of preserving the ecological integrity of Canada's parks and wilderness areas. The last part of the test, was satisfied because the petitioners'

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90 (5 October 1995), (B.C.S.C.) [unreported].

91 *Supra* note 83.

92 [1992] 1 S.C.R. 236.

claim was that Environment and Forests had improperly or unlawfully exercised their discretion, they were seeking review under the appropriate mechanism of the *Judicial Review Procedure Act*,[93] and the permits pertained to a large unpopulated area of wilderness of special interest to the petitioners.

In determining the appropriateness of a stay or interim injunction as forms of relief, the judge stated that the factors to be considered were similar, namely, whether there is a fair question to be tried and whether the balance of convenience favours the granting of the relief sought. As to the first factor, it had been shown in respect of the standing issue there was serious and justiciable issue in respect of the exercise of discretion in the issuance of the permits. With respect to the balance of convenience, the judge concluded that it favoured a stay or interim injunction because the petitioners contended that both Environment and Forests had recognized that the construction of the access road could result in significant irreparable damage to the environment. The seriousness of the damage outweighed, for the purpose of the application, the considerable financial losses that would be incurred by Imperial Oil if the construction stopped. To minimize the losses the date of the hearing was set for ten days hence. In the result, the judge ordered a stay of the permits and stated that, if this decision was wrong, he was satisfied that an interim injunction should be ordered until the petition was heard.

The judge also addressed the usual undertaking for damages and held that it would not be imposed in this case because the petitioners could not meet the financial obligation, the potential environmental damage if the road construction continued was serious and the petition would be heard a few days later.

3. Comments

One important significant aspect of this case lies in its application of the general test for an interlocutory injunction to the specific case of an injunction to prevent further work on a proposed oil well which had already received all the necessary authorizations. The discussion of the standing of an environmental group to bring an interlocutory application of this kind is also particularly significant.

J. *CHETWYND ENVIRONMENTAL SOCIETY* v. *DAWSON CREEK FOREST DISTRICT (DISTRICT MANAGER)*[94]

This case considers whether Forests applied the correct test when granting a Licence to Cut for the purposes of the proposed construction of an access road to an exploratory natural gas well to be drilled by Imperial Oil. The case is to be read in conjunction with the two preceding cases.

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93 *Supra* note 88.

94 (1995), 13 B.C.L.R. (3d) 338 (S.C.).

1. Facts

Following the decision of Prowse J. on October 5, 1995, granting the stay of the road access permits in *Chetwynd Environmental Society* v. *British Columbia (Ministry of Forests, Dawson Creek Forest District)*,[95] discussed above, Holmes J. of the British Columbia Supreme Court heard the application of the Petitioners on October 10, 1995. The petition was under the *Judicial Review Procedure Act*[96] to quash the Temporary Crown Land Use Permit issued to Imperial and for an order in the nature of *certiorari* quashing the License to Cut issued by the respondent Minister of Forests on September 15, 1995. A declaration was also sought that to grant a Licence to Cut Timber on Belcourt Road would violate the legislated mandate of Forests.

The background to the application is set out in part in the decision of *Koopman*[97] where Allen J. upheld the Well Authorization granted to Imperial Oil, but quashed the Licence to Cut timber for the construction of the access road to the wellsite on the grounds that Forests had fettered its discretion as a result of a misapprehension that it was compelled to issue the Licence to Cut in view of Energy's approval of the well authorization. Imperial Oil applied afresh for a Licence to Cut on August 23, 1995. On September 15, 1995, the minister issued a new Licence to Cut and gave written "notes" or reasons for his decision. The petitioners claimed that the minister committed a reviewable error in limiting the scope of his discretion to a consideration of the impact of harvesting trees but not the impact of road construction or by relying on the permission to construct the access road granted by Energy.

The petitioners also objected to the Temporary Crown Land Use Permit on the basis that the issuance process was flawed. This issue was not before Allan J. in *Koopman* because, as intervenors, they were unable to add this issue to the petition. The Crown's position was that the permit was not necessary as the approval authority given under s. 7 of the *PNGA*[98] was sufficient to authorize construction of the access road. Imperial Oil agreed with this position and argued that the petitioners did not pursue alternative effective remedies available to it.

2. Decision

As to the Temporary Crown Land Use Permit, Holmes J. stated that the petitioners did not have an adequate alternative statutory remedy. The pre-decision remedy under s. 59 of the *Land Act*[99] that permitted a notice of objection to be filed was not required because, as both the Department of Lands ("Lands") and Environment opposed the proposal, there was no indication a hearing to oppose was required. Since the Crown took no position to uphold the validity of the temporary permit, and the

[95] *Supra* note 90.
[96] *Supra* note 88.
[97] *Supra* note 83.
[98] *Supra* note 86.
[99] R.S.B.C. 1990, c. 4.

evidence indicated Lands' objection to the proposal, and as there was an inference that the permit was issued as a matter of course, the judge quashed the permit.

The judge then turned to the effect of s. 7 of the *PNGA* and reviewed the conclusion in *Koopman* of Allan J. that:

> s. 7 of the PNGA is sufficiently broad to encompass construction of roads for exploratory and development purposes and it empowered Mr. Ostergaard to authorize Imperial's entry, occupation and use of Crown land for natural gas and petroleum development and to impose terms on that use of the land. Those terms included obtaining a Licence to Cut from Forests and a temporary permit from Environment to build an access road.[100]

Holmes J. noted that there was no evidence filed in *Koopman* relating to there being a "term" in the s. 7 approval and an affidavit confirmed that no such condition was, in fact, imposed. Based on this, the judge stated:

> I accept therefore that Imperial although now without a Temporary Crown Use Permit under the Land Act has the authority to construct and access road to the well site under the approval granted to it by Energy under s. 7 of the *Petroleum and Natural Gas Act.*[101]

The remaining issue was whether the respondent Dyer committed a reviewable error in limiting the scope of his discretion. The petitioners claimed that his reasons disclosed the following fundamental errors:

(1) he failed to exercise his discretion to refuse the permit, despite his conclusion that the road was environmentally unacceptable to himself and Forests;
(2) he erred in taking an artificially narrow view of his jurisdiction, limited only to the environmental effects of the harvesting of timber (*i.e.* failure to consider relevant considerations, or jurisdictional error);
(3) he continued to fetter his discretion, based on the grant of the well authorization by Energy, contrary to the decision of Justice Allen; and
(4) he failed to consider the harvesting of timber for road construction as a "forest practice" pursuant to the *Code,*[102] and failed to exercise his mandate pursuant to that *Act*, the *Forest Act* and the *Ministry of Forests Act.*[103]

Holmes J. held that the minister's reasons disclosed he comprehensively reviewed available material concerning the original application, made a studied analysis of the decision of Allan J. in *Koopman*[104] and that he referred to the applicable governing statutes and regulations. The minister noted Forests' continued opposition to the project and concern that the company would be unable to rehabilitate the area to its former state. He stated that these concerns were not relevant to the decision to issue a Licence

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100 *Supra* note 83 at 161.
101 *Supra* note 94 at 344.
102 *Supra* note 89.
103 R.S.B.C. 1979, c. 272.
104 *Supra* note 83.

to Cut. His duty was to be satisfied that the timber on the right-of-way could be cut without causing damage to the environment. He was satisfied that this could be done through company compliance with the terms of the Licence to Cut and the logging plan. He therefore concluded that their previous objections, although valid concerns, were not valid reasons to disallow the Licence to Cut.

Holmes J. reviewed the legislation and the case law and concluded that the Licence to Cut was properly issued. He added that, in order to apply its discretion, it was not necessary for Forests to veto the road access permit already granted by Energy following an integrated economic and environmental study.

As a result, the petitioners failed to demonstrate reviewable error in respect of the Licence to Cut and the order for *certiorari* and the declarations sought for relief were denied. Each party was ordered to bear its separate costs.

3. Comments

The significance of this case is that the court upheld the minister's decision to consider only the issue of the environmental effects of the harvesting of timber for road construction before granting a Licence to Cut. The court rejected the argument of the environmental group that the issue considered by the minister was too narrow and that he should have conducted a review of the impact on the entire project before granting the Licence to Cut. When read in conjunction with the *Koopman* case, this decision provides some comfort to the oil and gas industry as it seeks to obtain approvals for new projects. Although each ministry must give independent consideration to the aspect of the project which lies within their jurisdiction, there is no requirement to reconsider the merits of the entire project for each licence once the merits of the project in a broader sense have been fully considered by one licensing body.

K. *PETRO-CANADA* v. *CANADA (CANADA-NEWFOUNDLAND OFFSHORE PETROLEUM BOARD)*[105]

This decision considers the correct interpretation of the term "significant discovery." It attempts to distinguish between the terms "commercial discovery" and "significant discovery."

1. Facts

Petro-Canada, together with its partners, applied for a declaration of "significant discovery" for the King's Cove A-26 offshore petroleum well. As operator, Petro-Canada had run certain tests, including one that produced 1.6 cubic metres (ten barrels) of oil at the surface. During the test there was a decline of oil from 6 percent to 0 percent. Petro-Canada had explained this decline as resulting from the failure of the cement/formation bond about half way through the test period. The Canada-Newfoundland Offshore Petroleum Board ("Board") informed Petro-Canada on July 16,

[105] (1995), 127 D.L.R. (4th) 483 (Nfld. T.D.).

1991 that it proposed to make a decision that the well was not a "significant discovery." Petro-Canada then asked that its application be referred for hearing by the Oil and Gas Committee (the "Committee"), as provided in the legislation. The Committee forwarded its Report and Recommendation to the Board in May 1992. The Board then constituted a panel to consider the Committee's Report and Recommendation and to decide on the disposition of the application. On February 27, 1994, the Board concluded that the conditions necessary for a declaration of significant discovery with respect to the well had not been met. On December 5, 1994, Petro-Canada applied for an order in the nature of *certiorari* to have the Board's decision quashed.

2. Decision

Barry J. allowed the application, set aside the Board's decision and referred the matter back to the Board for a further hearing, decision and full reasons.

Under the legislation,[106] the Board was required to make a written declaration of significant discovery "in relation to those portions of the offshore area in respect of which there are reasonable grounds to believe that the significant discovery may extend." A review of the Board's decision indicated that the Board had applied a test that appeared to be that of a "commercial discovery" under the legislation, as opposed to a "significant discovery." The definition of "commercial discovery" was "a discovery of petroleum that has been demonstrated to contain petroleum reserves that justify the investment of capital and effort to bring the discovery to production." The definition of "significant discovery" was "a discovery indicated by the first well on a geological feature that demonstrates by flow testing the existence of hydrocarbons in that feature and, having regard to geological and engineering factors, suggests the existence of an accumulation of hydrocarbons that has potential for sustained production.[107]

The Supreme Court of Canada decision in *Mobil Oil Canada Ltd.* v. *Canada (Canada-Newfoundland Offshore Petroleum Board)*[108] referred to the significant discovery test as an "objective test which favours industry participants." Iacobucci J. in that case pointed out that an applicant had a right of procedural fairness "because of the significant effect on the applicant's investment if a declaration of significant discovery is not obtained."

The Board had adopted the Committee's report in reaching its decision. The Committee's report reviewed the engineering analysis and geological factors but did not expressly refer to the standard of proof which it imposed upon the applicants for a significant discovery declaration, nor did the Board do so in its decision.

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106 *Canada-Newfoundland and Atlantic Accord Implementation (Newfoundland) Act*, N.S. 1986, c. 37 and *Canada-Newfoundland Atlantic Accord Implementation Act*, S.C. 1987, c. 3 [hereinafter "the legislation"].

107 *Supra* note 105 at 486-87.

108 [1994] 1 S.C.R. 202.

After reviewing the case law on judicial review, the standard of review adopted by Barry J. in relation to the Board's decision was "correctness" on legal issues and "reasonability" in the weighing of the various factors contemplated by the legislation.[109]

Barry J. determined that the reasons given by the Board were not adequate. The Board had a statutory obligation to provide reasons, including reference to the burden of proof applied by it and had failed to meet this obligation. The statutory language supported the conclusion that the proper burden to impose on the applicants was that suggested by Reed J. in *Mobil Oil.* Under that test, the applicants would be required to prove "reasonable grounds to believe there is a possibility of sustained production, that is, reasonable grounds to believe sustained production may be practicable." The phrase "reasonable promise of continuous production" adopted by the Committee, was, in the view of the Court, an acceptable statement of what the applicants were required to prove, but neither the Committee nor the Board made it clear that they in fact had applied this standard throughout their analysis of the evidence.

The Court emphasized that the Board was required to act in a scientific fashion on the basis of scientific knowledge and concluded that evidential reliability in a case involving scientific evidence should be based upon scientific validity. The Board was entitled to consider whether Petro-Canada's propositions were generally accepted by a scientific community. Petro-Canada had the legal burden of proving on a preponderance of probabilities the suggestion of a possibility. This constituted a "fairly generous test." The applicants were required "to produce sufficient unrefuted data, hypothesis and theories to satisfy the Board that the possibility was more than a random one or based just on chance or unsupported speculation."[110] Instead, the Board appeared to have applied a test requiring Petro-Canada to prove "the *likelihood* of sustained production, instead of just the *possibility* of this."

Petro-Canada further took the position that the requirement imposed by the Board to produce oil at the surface set forth in the Drilling Program Authorization and the draft regulations was improper as the Board did not have jurisdiction under the legislation to impose this requirement. Barry J. dismissed this submission on the basis that the wording of the legislation was broad enough to permit the Board to incorporate these conditions by reference. As well, Petro-Canada knew before it started drilling that the condition had been imposed.

Petro-Canada also submitted that consideration by the Board of the volume of oil and the economics of production was improper. The judge disagreed and adopted the Committee's conclusion that "[i]n a broad sense, evidence is required to suggest that the feature is of sufficient magnitude and quality to hold reasonable promise of continuous production of a volume to warrant the effort of producing it," and agreed with the Committee's conclusion that the legislation requires the Board to look for

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109 *Mobil Oil Canada Ltd.* v. *Canada (Minister of Energy, Mine and Resources)* (1990), 35 F.T.R. 50 [hereinafter *Mobil Oil*].

110 *Supra* note 105 at 484.

"some winning combination of size and quality of the accumulation, and technology and economics such that these hydrocarbons could be profitably produced."[111]

3. Comments

While this case attempts to distinguish between the definitions of commercial discovery and significant discovery under the legislation in very general terms, it leaves this question largely for the Board to determine on the basis of scientific analysis and review. The test could be problematic without clear guidelines for the oil industry to meet in order to assess the viability of drilling and testing in offshore areas. What is clear is that the condition to produce oil at the surface imposed by the Board was held to be valid as well as its consideration of the volume of oil and the economics of production.

VII. TAX

A. *J.M. HUBER CORP.* v. *ALBERTA (PROVINCIAL TREASURER)*[112]

This decision discusses the discretion granted to the Provincial Treasurer in determining whether any particular transaction causes an "artificial increase" in the Alberta Royalty Tax Credit ("ARTC") claimed by associated companies. It also considers the proper test for determining whether a transaction has caused an "artificial increase."

1. Facts

J.M. Huber Corp. ("Huber") entered into a carve out agreement with another company for the purpose of optimizing the income tax and business aspects of their operations. Huber had already earned the maximum ARTC available and the agreement had the effect of allowing the second company to claim an ARTC as well. The Director of Audit reassessed Huber, deemed it to be associated with the second company for the purposes of the *Alberta Corporate Tax Act*,[113] and disallowed a portion of its ARTC claim. The Director of Audit acted under the authority of ss. 26.1(8) and 26.1(10) which provided:

> (8) In computing the Alberta Crown royalty of a corporation, no amount shall be included that would, if included, artificially increase the Alberta Crown royalty of that corporation.
>
> (10) If, in the opinion of the Provincial Treasurer, two or more corporations have at any time entered into one or more sales, exchanges, declarations of trust or other transactions that
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> (a) lack any substantial business purpose, other than increasing the aggregate amount of the royalty tax credit that may be claimed, or

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[111] *Ibid.* at 507.

[112] (1995), 33 Alta. L.R. (3d) 92 (Q.B.).

[113] R.S.A. 1980, c. A-17 [hereinafter *ACTA*].

(b) artificially increase the royalty tax credit that may be claimed,

the Provincial Treasurer may direct that all of those corporations shall be deemed to be associated with each other for the purposes of this Division.

Huber applied for judicial review of the director's decision.

2. Decision

Justice Forsyth began by noting that the ARTC was one response of the Alberta government to the federal government's decision to eliminate the deductibility of provincial Crown royalties in the calculation of taxable income and that the provincial government has capped the ARTC at two million dollars per company or group of associated companies. The actions of the treasurer at issue in this case were taken pursuant to the anti-avoidance provisions in the *Act*.

Forsyth J. made four important holdings in this case, as follows:

(1) The treasurer is granted the discretion under the *ACTA* to deem companies to be associated with one another for the purposes of the *Act*, where, in his opinion the companies have entered into any transaction which has the effect of artificially increasing the ARTC to be claimed. The granting of this discretion in the ARTC suggests that deference ought to be paid to the treasurer's exercise of the discretion. Since there was no suggestion that the exercise of discretion was outside the treasurer's jurisdiction under the *ACTA*, the appropriate standard for review was reasonableness.

(2) The transaction between Huber and the second corporation was not entered into with the intent of artificially increasing the claimable ARTC, but rather for other tax and business considerations. However, the term "artificially increase" does not import a mental element into the analysis. The anti-avoidance rule is applicable even where the taxpayer entered into the transaction without the specific intention of avoiding taxes. The treasurer can look to the overall purpose of the transaction to decide if it is artificial for the purposes in the section. This is a valid exercise of his discretion. Moreover, the company's corporate officers were at least aware of the possibility that the taxation authorities might not view the transaction in the most favourable light. The treasurer's conclusions were not unreasonable in the circumstances, nor could it be said that he exercised his discretion for an improper purpose.

(3) Under the *Financial Administration Act*,[114] the treasurer was authorized to delegate discretionary power to others. The delegation of adjudicative and investigative powers to the Director of Audit was not improper. Considering the nature of the decision and the legislative scheme, the test for bias was not "a reasonable apprehension of bias" but rather that of "prejudgment" bias or

[114] R.S.A. 1980, c. F-9.

the "closed-mind" test. The legislature has granted a government official the right to decide unusual situations on a case-by-case basis, and the courts may intervene only to reverse an unreasonable decision. Otherwise, the recourse is to the Legislature. In this situation, the director's dual role as investigator and adjudicator did not necessarily give rise to an apprehension of bias. No formal hearing was required by the statute and the companies were given ample opportunity to make representations to the Director of Audit, so Huber was not deprived of a fair hearing.

(4) Although the treasurer had not erred in law by finding the transaction to be artificial, he had erred in law by deducting the artificial increase from both Huber and the second company. Section 26.1(8) of the *ACTA*[115] allocates the consequences of a denial of an ARTC benefit between the parties to an avoidance transaction, and is not a separate anti-avoidance scheme. Section 26.1(8) is mandatory in providing that no amount shall be included in calculating the ARTC of a corporation if it would cause an artificial increase in the ARTC of that corporation. Since Huber was already entitled to the maximum ARTC prior to the avoidance transaction, Huber's entitlement to the ARTC could not be characterized as being "artificially" increased. Therefore, Huber's ARTC could not be decreased under subsection 8. However, to the extent that the second company was entitled to an ARTC as a result of the avoidance transaction, that was an artificial increase. The second company's ARTC entitlement should be reduced to the extent of that artificial increase. The result of applying the section in this manner was to accomplish what the statute intended: to ensure that the ARTC cap was not breached by virtue an artificial transaction.

Since the treasurer made an error in law by wrongly applying s. 26.1(8) to a transaction which he properly found to be artificial, the Notice of Reassessment was quashed and Huber was entitled to recover money paid to the Treasurer as a result of the improper reassessment.

3. Comments

This case is important because it establishes the broad discretion which the treasurer has in determining whether any particular transaction causes a "artificial increase" in the ARTC claimed by associated companies. The case stands for the proposition that the treasurer may delegate his decision making authority on this point to others and that the decision may only be interfered with if it is unreasonable. The case shows that companies which associate with each other for other tax or business reasons must consider carefully the impact this may have on a potential claim for ARTC. An intention to increase the amount of ARTC claimable is not necessary for a transaction to be characterized as artificial. The case is also helpful in setting out clearly that only the increase after the transaction between the two companies can be denied by the treasurer. The section is not intended to be punitive and the companies are still entitled

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115 *Supra* note 113.

to the ARTC which would have been available to them prior to entering into an avoidance transaction.

B. *GULF CANADA RESOURCES LTD.* v. *CANADA*[116]

The issue in this case is the proper calculation of the resource allowance under Part XII of the *Income Tax Regulations*.[117] The specific issues considered are whether there must be a viable production undertaking which is sufficiently well established to be capable of generating a profit in the near future in order for there to be resource profits, and whether certain sums were properly to be considered deductions for purposes of calculating the resource allowance.

1. Facts

The Syncrude mega-project was designed to produce synthetic crude oil from oil sands and consisted of three major components: mining, extraction (separating the bitumen from the sands) and upgrading (processing the bitumen into light synthetic crude oil). In 1978, construction was completed on the mining component but continued on the extraction and upgrading components. The plant went through a "debugging period" and a number of problems were encountered in 1978 and in subsequent years.

The trial judge[118] held that in computing the resource profits for the purpose of the resource allowance, Syncrude was not being operated on the scale which could be expected to be profitable in 1978 or the near future. Therefore, there was no source of income for the purpose of the definition of resource profits in the calculation of the resource allowance in 1978. Since there was no source of income, there should be no deduction for capital cost allowance (approximately $45,000,000) or interest expense (approximately $9,000,000) relating to the project.

2. Decision

The Federal Court of Appeal held that the trial judge had erred in deciding that in order to have resource profits there had to be a business of a viable oil producing undertaking sufficiently well established to be capable of generating a profit in the near future.

The Court granted relief to Gulf Canada Resources Ltd. ("Gulf") on a different basis. It held that, in computing Gulf's resource profits, that part of the two deductions reasonably applicable to the extraction and upgrading operations were not deductible because they related to a source under s. 1204(3) of the *Regulations* which excludes from resource profits "income or loss derived from ... processing petroleum, natural gas or related hydrocarbons." Since the extraction of bitumen from the bituminous sands and the upgrading of that bitumen into crude oil are operations involving the processing

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[116] (26 January, 1996), A-195-95 (F.C.A.).

[117] C.R.C., c. 945 at 7155 [hereinafter *Regulations*].

[118] *Gulf Canada Resources Ltd.* v. *Canada* (3 March 1995), T-1184-89 (F.C.T.D.).

of petroleum or related hydrocarbons, deductions relating to those activities were to be excluded from the calculation of resource profits.

3. Comments

The resource allowance provides a deduction calculated as 25 percent of "resource profits." It was introduced to partially offset the disallowance of the deduction of Crown royalties and mineral taxes. A reduction in resource profits reduces the value of the resource allowance, so taxpayers seek to avoid deductions to resource profits.

This was the second big case for Gulf in respect the calculation of resource allowance. Both involved Syncrude. An earlier case in 1990, confirmed on appeal in 1992, dealt with Gulf's 1974 and 1975 taxation years. In that case, it was held that Syncrude was not a source of income for the purpose of the resource allowance in those years and, therefore, scientific research expenditures and capital cost allowance were not deductible in computing resource profits. This case dealt with a different aspect of the resource allowance, namely, the scope of the exclusion in s. 1204(3) of the *Regulations* in relation to the Syncrude project and to what extent the activities at Syncrude fell within the exclusion. The earlier decision and a related case concerning general and administrative expenses prompted the federal Department of Finance to issue draft rules in 1992 to negate the decision for future taxation years. Husky and the tax authorities consented to judgment for the 1976 and 1977 taxation years on the basis that Syncrude was not a source of income in those years.

After the first Gulf case was decided, resource companies refiled tax returns claiming higher resource profits. A number of measures were taken by the tax authorities in response to this action and the political pressure to close the "loophole." In 1995, five different options were proposed. In March 1996, a moratorium was imposed on tax refunds. The government has indicated that it will only pay out a maximum industry refund of $1.2 billion and is attempting to sort out estimates of all refund claims before agreeing to any further settlements. One estimate is that the claims could total $4 billion.

In the 1996 budget, draft rules and explanatory information were included to clarify the calculation of resource profits after July 22, 1992. The new approach is to calculate resource profits based on net income for tax purposes, with add-backs for Canadian exploration expense, Canadian development expense, Canadian oil and gas production expense, depletion and interest.

C. *M.N.R.* v. *SAND EXPLORATION LTD.*[119]

This decision considers whether the Minister of National Revenue (the "Minister") was entitled to compel the respondents to provide a list of names and addresses of all purchasers of its seismic data and the purchase dates.

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[119] [1995] 3 F.C. 44 (F.C.T.D.).

1. Facts

The Minister obtained an *ex parte* order under the *Income Tax Act*[120] requiring the respondents to provide a list of the names and addresses of all purchasers of its seismic data and the purchase dates. The respondents applied for a review of this order to determine whether the conditions in paragraphs (a) to (d) of s. 231.2(3) had been satisfied. If the requirements are satisfied by information on oath, this provision authorizes the Minister to impose on a third party a requirement relating to an unnamed person or persons. The requirements are:

(1) the person or group is ascertainable;
(2) the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under the *ITA*;
(3) it is reasonable to expect, based on any grounds, including information (statistical or otherwise) or past experience relating to the group or any other persons, that the person or any person in the group may have failed or may be likely to fail to provide information that is sought pursuant to the requirement or to otherwise comply with the *ITA*; and
(4) the information or document is not otherwise more readily available.

2. Decision

Rothstein J. held that the requirements were satisfied by the evidence presented by the Minister. He distinguished the case of *James Richardson & Sons Ltd.* v. *M.N.R.*[121] which prohibited a survey requested by the Minister of unnamed commodity traders and held that a predecessor provision to s. 231.2 of the *ITA* was only available "to obtain information relevant to the tax liability of some specific person or persons if the tax liability of such person or persons is the subject of a genuine and serious inquiry."[122] Section 231.2 was an attempt to address the difficulties under the predecessor provision. It expressly provides a process with which the Minister must comply in order to require third parties to provide information or documents relating to unnamed taxpayers. The fact that the Minister may obtain a court order *ex parte* places an obligation on the Minister to act in the utmost good faith and to ensure full and frank disclosure of information.

The affidavit of an auditor with Revenue Canada and cross-examination on that affidavit disclosed that the respondents were in the business of selling seismic data which the Minister was concerned had been inflated solely for the purpose of providing an excessive tax deduction for the investors. Three appraisals were introduced that indicated that the seismic data had been grossly inflated (*e.g.* certain data purchased for $100,000 was appraised at $21,000). Unsatisfactory responses had been given by known investors concerning intention to explore for oil and gas using the seismic data, which called into question whether the data had been purchased for the purpose of gaining or

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[120] R.S.C. 1985 (5th Supp.), c. 1 [hereinafter *ITA*].
[121] [1984] 4 W.W.R. 577 S.C.C.
[122] *Supra* note 119.

producing income from a business or property or as a Canadian exploration expense. If the transactions had no business purpose, or were not Canadian exploration expenses, the purchasers would not be entitled to any deduction. From this evidence, Rothstein J. was satisfied that the Minister had complied with the requirements of the *ITA* ensuring the Minister, in seeking the names of unnamed taxpayers from third parties was not conducting a fishing expedition, but rather was conducting a serious inquiry. Even on a restrictive interpretation of the provision, the Minister had satisfied these requirements.

3. Comments

This case explains the review process for an *ex parte* order under s. 231.2 of the *ITA*. Where there is a concern that complying with the order could breach a duty of confidentiality, a review of such order would protect the party being required to make disclosure against a breach of that duty.

D. *SUNCOR INC.* v. *CANADA*[123]

The issue in this case was whether Suncor Inc. ("Suncor") was entitled to the benefit of an exemption under the *Excise Tax Act*[124] for kerosene used as belt spray on conveyor belts in its oil sands plant and facilities on the grounds that the kerosene spray was incorporated into and formed a constituent or component part of the final product.

1. Facts

Suncor used kerosene as "belt spray" in the oil sands plant and facilities located near Fort McMurray. The kerosene was used on conveyor belts to avoid clogging of the bituminous sands on the series of conveyor belts carrying the sands from the giant extractors to the plant. Some of the kerosene was lost by misting or evaporation and some proportion was reabsorbed in the raw material and extracted again as a product at the end of the line. Suncor claimed that it was being doubly taxed in respect of the kerosene used as belt spray because it was not given the benefit of the exemption under s. 23(7) of the *Excise Act* for goods that are incorporated into and form a constituent or component part of a product that is subject to excise duty under that *Act*.

Joyal J. of the Federal Court Trial Division[125] first reviewed the interpretation of "diesel fuel" and held that the kerosene belt spray constituted diesel fuel within the meaning of the *Excise Act* and therefore was taxable under s. 23(1). The Court then stated that the question was what portion of the belt spray kerosene was fed back into the system, or put another way, how much of it was lost through misting and evaporation. The experts provided two different ranges and the Court made adjustments to these two ranges to account for differences in the analysis used by each expert, and

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[123] (21 March 1996), A-265-95 (F.C.A.).

[124] R.S.C. 1985, c. E-15 [hereinafter *Excise Act*].

[125] [1995] 90 F.T.R. 22.

used the median between the adjusted figures of the experts, then took the median of these two percentages to arrive at a result of one-third as being the amount of kerosene lost. This was the amount of kerosene in question that was found to be taxable. The Crown appealed contesting whether the exemption applied at all and Suncor cross-appealed taking the position that the exemption should apply to all of the belt spray kerosene, not just two-thirds of it.

2. Decision

On appeal, the finding of the trial judge that one-third of the belt spray kerosene used by Suncor was lost while two-thirds adhered to the oil sand and was reintroduced into the production process resulting in a correspondingly higher yield in the volume of kerosene at the end of the process was not put into issue.

Suncor's position on the appeal was that it should not be liable for tax on any part of the belt spray kerosene because it did not "use" it in the sense of consuming it. Hugessen J.A. dismissed this argument stating:

> [t]he word "use" itself is quite broad enough to cover what the respondent does with the belt spray kerosene... The kerosene is sprayed on the conveyor belt to assist the latter's function of transporting the oil sands. That is its use and what it is useful for. The one-third in volume of the kerosene which is lost to evaporation, misting and the like, is used up in the process in very much the same way as is the other kerosene which issued by the respondent for the purposes of fuelling diesel engines in the plant.[126]

Suncor's related argument that the belt spray kerosene was simply taken out of the production process at a late stage and recycled in the same manner as a contaminated product or one that did not meet specifications was also dismissed. The judge stated that the analogy was inexact and misleading and that while a product which is defective and requires reprocessing is not being "used" such is not the case with the belt spray as it did not require reprocessing and was a finished product put into the production stream not for the sake of processing it but merely as an incident to its use as an aid in the processing of the oil sands. In the result, Suncor's argument that it did not use "the belt spray" kerosene was rejected and Suncor's cross-appeal was dismissed.

The Crown's position on the appeal was that the exemption did not apply because the belt spray kerosene was not purchased and did not become a constituent part of a final product. The Court held that the appropriation of the product to a taxpayer's use was deemed to be a delivery to a purchaser under the *Excise Act*.[127] Therefore, there was a deemed purchase which attracted the exemption. It was also held that the belt spray kerosene formed part of the final product even though it became mixed with the oil sands. As a result, the Crown's appeal was dismissed.

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[126] *Supra* note 123.

[127] *Supra* note 124.

3. Comments

From the comments of the trial judge, this looks like a *de minimus* case. The amount of tax at issue was not disclosed. It should be noted that the Court was dealing with the tax for two months only and the decision effectively saved the taxpayer a considerable amount of tax over the long term. The double tax holding of the Court of Appeal may have broader implications for oil companies, allowing them to claim refunds of excise tax on substances produced in the refining process that are used again in the refining process and get reabsorbed and become part of the refined product.

VIII. DIRECTORS LIABILITY

A. *R.* v. *BATA INDUSTRIES LTD.*[128]

This decision considers the circumstances under which a corporation may or must indemnify a director or officer for liability incurred due to environmental offences committed by the company. It also considers whether or not a court is entitled to restrict the indemnification of a director by means of a probation order imposed upon the corporation.

1. Facts

Bata Industries Ltd. ("Bata") was convicted of causing or permitting an unlawful discharge of liquid industrial waste contrary to the *Ontario Water Resources Act.*[129] Two directors of Bata were convicted of failing to take all reasonable care to prevent Bata from causing or permitting the unlawful discharge. The trial judge imposed a fine of $120,000 on Bata and fines of $12,000 on each of the directors. In addition, the trial judge imposed a Probation Order on Bata, one of the terms of which prohibited Bata from indemnifying the directors for the fines imposed on them. The fines against Bata and the directors were reduced to $90,000 and $6,000, respectively, on appeal. However, the appellate court judge affirmed the prohibition against indemnifying the directors in the Probation Order. Bata appealed the non-indemnification provision of the Probation Order to the Ontario Court of Appeal.

2. Decision

The Ontario Court of Appeal struck down the non-indemnification provision of the Probation Order on two grounds:

(1) Since the *Ontario Water Resources Act*[130] is a provincial statute, the court's only authority to impose a Probation Order is set out in the *Provincial Offences Act.*[131] That *Act* allows the court to prescribe conditions in a

[128] (1995), 22 B.L.R. (2d) 135 (Ont. C.A.).
[129] R.S.O. 1980, c. 361.
[130] *Ibid.*
[131] R.S.O. 1980, c. 54.

Probation Order which the court considers appropriate to prevent similar unlawful conduct or to contribute to the rehabilitation of the defendant. Since the statutory basis for additional conditions is the deterrence and rehabilitation of the defendant, the only legitimate purpose of the non-indemnification provision of the Probation Order against Bata would have been deterrence and rehabilitation of Bata. However, the reasons of the trial judge and the appeal court judge make it clear that the main purpose of the non-indemnification provision was to ensure that the directors were appropriately punished. That was an improper use of a condition on a Probation Order.

2. The *Ontario Business Corporations Act*[132] establishes the circumstances under which a corporation may and must indemnify a director or officer, and by implication also establishes the circumstances under which the corporation cannot indemnify a director or officer. The *OBCA* provides a comprehensive code by which the indemnification of corporate officers and directors is regulated. This statutory scheme is enforced by another provision of the *OBCA* which imposes liability on a director who votes for indemnification in circumstances other than those permitted or required by the *Act*. Bata should be entitled to indemnify directors to the extent that it is lawful to do so under the *OBCA*.

The Court elaborated on the indemnification provisions in the *OBCA*. The *OBCA* provides that indemnification is permissible if a director acted honestly, in good faith and in a reasonable belief that his conduct was lawful. The *OBCA* provides that indemnification is required where a director has been substantially successful on the merits of the case. The by-laws of Bata prohibited indemnifying directors unless they were substantially successful on the merits of the case. If the trial judge was correct that the directors had not been substantially successful, because they had been fined, then the Probation Order would be superfluous. However, if the directors satisfied these requirements, then the non-indemnification provision of the Probation Order contradicted the *OBCA*. The Court held that absent compelling circumstances, it is not appropriate to impose a term of probation that would deny directors access to legislation which is to be intended to be of general application on the issue of indemnification. The Court also noted that as a practical consideration, because a Probation Order can only be effective for a maximum of two years, Bata could indemnify its directors unencumbered by the Probation Order, simply by waiting for it to expire. Thus, the non-indemnification provision of the Probation Order was not effective to advance general deterrence objectives.

3. Comments

The Bata decision is of particular interest for its consideration of the indemnification provisions of the *OBCA*. The Court of Appeal expressly termed the legislation a "comprehensive code" regulating the indemnification of officers and directors. The Court of Appeal affirmed the intention of the legislature to allow a corporation to

[132] R.S.O. 1990, c. B-16 [hereinafter *OBCA*].

decide whether to indemnify its directors and officers and endorse the validity of corporate by-laws which limit a director's entitlement to indemnification when not required by the legislation.

The decision of the Ontario Court of Appeal appears to be good public policy. Corporate officers and directors can now act with the security that honesty and a reasonable belief in the lawfulness of their actions are a defence to personal liability for actions taken as director. Directors and officers must still be aware of and abide by their environmental responsibilities. However, directors now have the assurance that if they are convicted of an environmental or other offence they will be allowed to seek indemnification from the corporation provided that they have satisfied the criteria in the relevant business corporations statute and any applicable by-laws of the company. This may help to attract competent individuals to undertake directorships in Canadian companies.

B. *CONSOLIDATED ENFIELD CORP.* v. *BLAIR*[133]

This case considers the test for determining whether a director or officer will be entitled to indemnification by the corporation for acts undertaken while director and the scope of the requirement that a director be acting in good faith and in the best interests of the corporation in order to receive indemnification.

1. Facts

The respondent was a director and the chief executive officer of the appellant corporation. Prior to the 1989 annual meeting, there had been a dispute between the respondent and a new controlling shareholder. However, the new shareholder and the respondent had agreed to a management slate of directors which included the respondent prior to the meeting and proxies were issued on that basis. The respondent chaired the annual meeting. At the meeting, representatives of the new shareholder nominated a new person from the floor and voted their shares to oust the respondent.

The tactics of the new shareholder were not entirely unforeseen. The respondent had taken legal advice from the solicitors for the corporation prior to the meeting and again during the meeting sought advice from the solicitors. The solicitors informed the respondent that the ballots cast against him were invalid because the proxies which authorized the ballots restricted the proxyholders to voting for the management slate. The respondent acted on the advice of the solicitors and held the proxies invalid with the result that he was re-elected and the nominee of the new shareholder was not elected.

The new shareholder brought a court application against the respondent and the appellant corporation. The Court held that the solicitors for the appellant corporation had been mistaken and that in fact the ballots were legally cast. The Court awarded costs against the respondent and the appellant corporation. In a subsequent meeting the

133 (1995), 128 D.L.R. (4th) 73 (S.C.C.).

new shareholder gained control of the board of the appellant corporation and ousted the respondent. The respondent then brought an application for a declaration that he was entitled to be indemnified by the appellant corporation for the order of costs. He brought the application pursuant to a by-law of the appellant corporation, which was to the same effect as s. 136(1) of the *OBCA*.[134] That section provides that a corporation may indemnify a former director against costs reasonably incurred by him in any proceeding to which he is made a party if he acted honestly and in good faith with a view to the best interests of the corporation.

The trial judge dismissed the application but the Ontario Court of Appeal allowed the appeal.

2. Decision

Justice Iacobucci delivered the unanimous decision of the seven-member panel which heard the appeal at the Supreme Court of Canada. He held that the onus of proving lack of good faith rested on the appellant corporation and that it had failed to do so. He also held that the respondent had fulfilled the three conditions set out in s. 136(1) to receive indemnification, specifically:

(1) he was made a party to the litigation by reason of being a director or officer of the respondent;
(2) the costs were reasonably incurred; and
(3) he acted honestly and in good faith with a view to promoting the best interests of the appellant.

Iacobucci J. noted particularly that the respondent acted not in his personal capacity but in his capacity as director and chairman of the appellant corporation. The Court noted that reliance on the advice of counsel is recognized in s. 135(4)(b) of the *OBCA* as fulfilling a director's standard of care. By relying on the advice of counsel, the respondent sought to protect the interests of the shareholders who were not present at the meeting. The Court stated that indemnification is designed to encourage responsible behaviour by directors yet still attract strong candidates to directorships. Therefore, indemnification should only be denied in the case of *mala fides* on the part of a director.

The Court held that the respondent was entitled to solicitor-client costs at all levels of court in the indemnification action in order that he be fully indemnified for the actions he undertook as director.

3. Comments

The decision of the Supreme Court of Canada in this case provides some additional assurances for persons undertaking directorships that they will be indemnified for good faith actions taken in their capacity as director. The Court has unequivocally recognized

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[134] *Supra* note 132.

that a director will be entitled to indemnification where his actions result from good faith reliance on legal advice. Presumably, the principle established in this case can be extended to good faith reliance on other professional advice. In addition, the Court restricted the time at which to apply the test of acting in good faith and in the best interests of the corporation. The Court rejected the appellant corporation's argument that in addition to acting in good faith while acting as director, a director must also act in good faith during the course of litigation arising from those actions or in seeking indemnification from the corporation. The Supreme Court's decision upholds the plain wording of the *OBCA* and provides much needed security for persons undertaking directorships.

C. *UNITED STATES* v. *IVEY*[135]

The issue in this case was whether a U.S. judgment obtained against a corporate director in his personal capacity was enforceable in Ontario. The liability arose from environmental clean-up costs incurred by the U.S. Environmental Protection Agency on behalf of the company in which the director held a controlling interest. At the time that the cleanup costs were incurred, the company was bankrupt.

1. Facts

The defendant Ivey was the President and Chief Executive Officer of an Ontario holding company which held the controlling interest in Liquid Disposal Inc. ("LDI"), a Michigan corporation which conducted a waste disposal business. After an accident at the waste disposal site, LDI was forced into bankruptcy. Subsequently, the Environmental Protection Agency ("EPA") conducted four removal and cleanup operations at the LDI site. In 1989, the plaintiff obtained a judgment for the costs of cleanup incurred by the EPA against Ivey personally and two Ontario holding corporations controlled by him. A judgment was obtained pursuant to the *Comprehensive Environmental Response, Compensation and Liability Act.*[136] The Michigan judge found that Ivey was properly characterized as an "owner or operator" and thus liable under s. 9607(a) of *CERCLA* for clean-up costs incurred by the EPA at the LDI site. The plaintiff then sought to enforce the two Michigan judgments in Ontario.

2. Decision

Sharpe J. held that the test for whether or not the Michigan District Court had jurisdiction over the defendants was the "real and substantial connection" test established by the Supreme Court of Canada in *Morguard Investments Ltd.* v. *De Savoye.*[137] He held that although that decision dealt specifically with the recognition and enforcement of a judgment of the courts of one province by the courts of another

135 (1995), 26 O.R. (3d) 533 (Ont. Ct. (Gen. Div.)).

136 42 U.S.C.A. (1980) [hereinafter *CERCLA*].

137 [1990] 3 S.C.R. 1077 [hereinafter *Morguard Investments*].

province, the reasoning should apply to the enforcement of this U.S. judgment. He stated:

> In my view, the law would be seriously deficient and at odds with the reality of modern commercial life if it were possible for a resident of this province to actively engage in a business in the United States for a period of several years, but then shelter behind the borders of Ontario from answering to a claim for civil liability for harm caused by that activity.[138]

Sharpe J. held that there was a real and substantial connection between the defendants and the jurisdiction of the Michigan District Court. Ivey was a principal officer of the corporations and was regularly present in Michigan to make decisions concerning the environmental issues which gave rise to the claim.

Sharpe J. rejected the defendant's argument that enforcement should be refused on the grounds that *CERCLA* is a "penal," "revenue" or "public" law. The measure of recovery is tied directly to the cost of the required environmental clean-up. The law is restitutionary in nature and is not imposed with a view to the punishment of the party responsible. Likewise, since the damages were measured directly and precisely on the cost of the remedial measures, there was no basis for arguing that the judgments were a form of taxation. The doctrine that "public law" judgments ought not to be enforced was based on shaky foundations and the cases were readily distinguishable on the ground that this was not an attempt by a foreign state to assert its sovereignty within the territory of Ontario. Also, policy grounds militated against expanding the "public law" defence to encompass environmental law and other areas of law where the traditional common law remedies have been effectively supplanted by detailed statutory and regulatory regimes. There is a public element to almost all statutes and virtually all suits brought by a government.

Sharpe J. held that the judgments obtained under *CERCLA* did not violate the principles of natural justice. Although *CERCLA* does not grant a full right of hearing, it does afford a limited right to present one's case, which the defendants had failed to take advantage of. He also held that enforcement should not be refused on public policy grounds simply because the judgments sought to be enforced depended on a law or a basis of liability more strict or severe than the law of the forum.

3. Comments

This judgment is illustrative of a new approach favouring the enforcement of foreign judgments, where reasonable to do so, following the decision of the Supreme Court of Canada in *Morguard Investments*.[139] Parties who engage in business in the United States or other foreign jurisdictions should be aware that both they and their assets in Canada may be held liable for environmental damage and other civil actions brought against them in the jurisdiction in which the business is carried on. This case demonstrates that foreign judgments will be enforced even where the foreign law

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138 *Supra* note 135 at 543.

139 *Supra* note 137.

imposes a stricter degree of liability on a director personally than would likely be the case under Canadian law.

D. *CANADA* v. *CANADA PIPE CO.*[140]

This is a sentencing decision under the *Competition Act.*[141]

1. Facts

The accused plead guilty to the charge that between January 1990 and September 30, 1990 it did lawfully conspire, combine, agree or arrange with United States Pipe and Foundry Company to prevent or lessen, unduly, competition in the supply and sale of ductile iron pipe in the mid-size range in Canada, contrary to s. 45(1)(c) of the *Competition Act.* Counsel for the parties presented an agreed statement of facts which was supplemented by oral submissions. They suggested a fine of $2,500,000.

2. Decision

The Court fined the accused $2,500,000 and issued an Order of Prohibition. McKeown J. stated that the only penalty provided under s. 45 for a corporation was a fine not exceeding $10 million and that the sentence should protect the public interest in free competition and should serve as a general and specific deterrent.

Six factors were relied on in deciding upon the sentence:

(1) Section 45, the conspiracy section, is at the core of the criminal portion of the *Compensation Act.*
(2) The role of the accused and its officers was a factor. In this case, the accused's president was the party who entered into the agreement on behalf of the accused and, therefore, one of the highest directing minds of the corporation was involved.
(3) The size of the accused and the volume of commerce affected had to be considered and the accused's sales of ductile iron pipe in Canada during the nine-month period between January and September 1990 was approximately $8 million. The fine suggested represented approximately 30 percent of the amount of the accused's business during this period. The accused had approximately 85 percent of the market in question.
(4) The fine suggested was in line with recent cases.
(5) The fine should also reflect the cost of investigation by the Crown which the Crown and the accused accepted was 20 percent of the proposed fine.
(6) The international context of this conspiracy could not be overlooked. The U.S. parent had the same president as the accused. The fine should be sufficient to deter persons outside the country from engaging in activities which violate the Canadian *Competition Act.*[142]

140 [1995] F.C.J. No. 1301 (Q.L.).
141 R.S.C. 1985, c. C-34.
142 *Ibid.*

The judge also considered the mitigating factors of a guilty plea, the co-operation of the accused with the Crown and the fact that the arrangement was not put into effect and that, during the period of the conspiracy, the price of ductile iron pipe went down; accordingly, the status of the victims was not as important as in other cases where there are victims of the conspiracy who have suffered losses.

3. Comments

The Court mentioned that this is the highest fine that has been imposed under the *Competition Act*. It is all the more significant in light of the fact that the conspiracy was not carried out. It is important that in dealings between larger oil companies, care is taken to avoid any agreements that contravene the *Competition Act*. The fact that such any such agreement is not carried out might mitigate the penalty, but will not avoid it.

IX. CREDITOR'S RIGHTS

A. *CANADIAN IMPERIAL BANK OF COMMERCE* v. *A.K. CONSTRUCTION (1988) LTD.*[143]

This case involves a priority dispute between a party which had perfected its security in serial-numbered equipment by registration and a party whose prior unperfected security interest was defeated by that registration. The party which perfected its security by registration had knowledge of the prior unperfected security interest.

1. Facts

The Canadian Imperial Bank of Commerce ("CIBC") and a trust company, RoyNat Inc. ("RoyNat"), both loaned money to the debtors for the acquisition of heavy construction equipment starting in about 1984. Initially, CIBC took security in the form of a general assignment of book debts, while RoyNat took security in the form of a fixed and floating charge debenture. In 1986, the parties entered into a priority agreement under which the RoyNat security in the accounts receivable was postponed to the interest of CIBC. In 1992, CIBC took additional security in the form of a general security agreement which covered the heavy equipment.

Heavy equipment is "serial number" equipment within the meaning of the *Personal Property Security Act*.[144] In 1993, after the debtor had defaulted on the loans to both CIBC and RoyNat, CIBC registered its security in the serial number equipment in the Personal Property Registry. At the time of registration, CIBC was aware of the prior unperfected security interest of RoyNat. RoyNat asserted that CIBC's actions in defeating RoyNat's prior unregistered interest was not in good faith and that therefore RoyNat should be held to have priority over CIBC.

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143 [1995] 8 W.W.R. 120 (Alta. Q.B.).

144 R.S.A. 1988, c. P-4.05 [hereinafter *PPSA*].

2. Decision

Justice Veit relied on s. 66(2) of the *PPSA* which states that "bad faith" requires some form of positive action on the part of the party with the perfected security interest which is more than mere knowledge that a prior unperfected security interest will be defeated by the registration. Although the CIBC had knowledge of RoyNat's security, this did not create any sort of estoppel against CIBC. The 1986 Priority Agreement did not deal with the priority of security in the serial-numbered goods and there was no evidence on which to rectify that agreement. The interest which was registered first, namely that of CIBC, took priority over the unregistered interest of RoyNat.

3. Comments

This is the first decision on the meaning of good faith under the *PPSA*. The decision applies the very specific wording of s. 66(2) of the *PPSA* which states that knowledge of a prior unperfected interest which will be affected by registration does not constitute bad faith. Given that there was no contractual agreement between the parties as to the priority of the security in the serial-numbered equipment, this decision appears to achieve the result intended by the Legislature. The decision establishes clearly that priority is determined by order of registration and that all parties will be entitled to rely on the register.

B. *BANK OF MONTREAL* v. *DYNEX PETROLEUM LTD.*[145]

This decision involved a priority dispute between the Bank of Montreal (the "Bank") which held a fixed and floating charge debenture, a general assignment of book debts and s. 426 *Bank Act*[146] security against producing petroleum and natural gas properties and the holders of overriding royalty and net profit interests in those properties. A preliminary application made by the Bank to determine whether various overriding royalty and net profit interests constituted an interest in land is discussed earlier in this article in Part III.F.

1. Facts

Dynex Petroleum Ltd. ("Dynex") gave the Bank a fixed and floating charge demand debenture, general assignment of book debts and security under the predecessor to s. 426 of the *Bank Act*[147] against all of Dynex's producing petroleum and natural gas properties and certain other security. After Dynex defaulted on its obligations, the Bank made demand on Dynex and the security under the floating charge debenture crystallized. A receiver was appointed by the court and a Statement of Claim issued by the Bank against Dynex and overriding royalty and net profit interest holders, wherein the Bank sought, as against those interests, a declaration that the security granted by Dynex to the Bank ranked in priority to those interests.

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145 *Supra* note 33.

146 R.S.C. 1985, c. B-1.

147 *Ibid.*

This decision arises from an interlocutory application for a determination of a question of law with respect to priority, brought by the holders of the overriding royalties and net profit interests. Before turning to that issue, Rooke J. ruled that issues pertaining to priorities after the date of bankruptcy should proceed to trial.

2. Decision

Rooke J. began his decision on the rights and priorities between the Bank and the overriding royalty and net profit interests holders with an illustration of how a bank and its energy industry clients proceed in a loan transaction. He placed emphasis on the fact that the lending values of oil and gas properties are determined taking into account the effect of prior economic interests, such as overriding royalties and net profit interests in those properties, and these are usually treated as prior encumbrances. He then asked the question of whether a bank ought to obtain priority over those prior encumbrances in a receivership and answered that question emphatically in the negative as a matter of common sense. Rooke J. then proceeded to examine whether the law in this matter accords with the common sense conclusion.

Rooke J. reviewed what actually happened in the structuring of the loan and security documents between the Bank and Dynex. He noted that the original general assignment under s. 82 of the *Bank Act* was subject to "overriding royalties noted in Schedule "A." He also noted that the later debenture defined Permitted Encumbrances as including "any interests of a third party under any ... farmout ... royalty or overriding royalty agreements or other similar interest in effect as of August 31, 1983"[148] [the date of the debenture]. Rooke J. also referred to the loan agreement and noted that the borrower covenanted to maintain and defend title and not to create or allow to exist any encumbrances except the permitted encumbrances. He therefore concluded that, at the time that the Bank took security in the Dynex properties, the Bank was relying on what Dynex actually owned, excepting out what Dynex did not own. The question of law was therefore whether that position was changed by the crystallization of the debenture and the appointment of a receiver.

Rooke J. began his analysis of the law by reiterating that he had previously determined that the overriding royalty interests in question were not interests in land, that is, they were not rights *in rem* but rather personalty or *in personam* rights. The discussion then focused on s. 40 of the *PPSA* which reads as follows:

> A secured party may in a Security Agreement or otherwise, subordinate his security interest to any other interest, and the subordination is effective according to its terms between the parties and may be enforced by a third party if a third party is the person, or one of a class of persons, for whose benefit the subordination was intended.[149]

148 *Supra* note 33 at 82.
149 *Supra* note 144.

Mr. Justice Rooke held that applying the terms in s. 40 of the *PPSA* to this case, the secured party would be the Bank, the other party would be Dynex and the third parties would be the holders of the overriding royalties or other related interests.

Rooke J. relied on *Chiips* v. *Skyview Hotels Ltd.*[150] which dealt with a general subordination clause and the right of a supplier to the benefit of that clause for interests of the supplier created after the date of the security interest. In this case, Rooke J. held that the *Chiips* principles applied all the more strongly because the subordination was specific, referenced by incorporation of specific agreements within a security document, and referred only to interests created prior to the date of the security agreement. It was clear that the Bank loaned money to the borrower taking into account the overriding royalty interests that existed against the property and that the Bank's security was subject to those interests.

Mr. Justice Rooke placed emphasis on the recognition of commercial reality in the decision of Foisy J.A. as set out in the head note to the *Chiips* case.

> The purpose of s. 40 is to allow a debtor subject to a broad-based security agreement to carry on business and acquire goods on credit.[151]

He noted that, the necessary changes being made, the same applies to the commercial reality in the oil and gas industry. He concluded:

> The recognition of overriding royalty interests and net profit interests is not only what the parties in general appear to do, but it is necessary for the commerce between the institutions. Failure to do so would have a significant disruptive effect both on the oil and gas industry and on the financial institutions.[152]

Rooke J. also relied on *Chiips* for the proposition that s. 40 of the *PPSA* removes any doubt created by the common law with respect to privity and that the overriding royalty holders were entitled to rely on the subordination clause although not in privity of contract with the Bank. He also held that s. 40 of the *PPSA* is procedural and therefore to be applied retrospectively to all pre-existing security agreements which have not been terminated under prior law.

3. Comments

Justice Rooke's decision has considerable implications for overriding royalty holders and lenders and the transferees of working interests. In particular:

(1) a royalty holder should ensure that the royalty is reflected on the records of the lessee as a recognized encumbrance; and

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150 (1994), 7 P.P.S.A.C. (2d) 23 (Alta. C.A.) [hereinafter *Chiips*].

151 *Ibid.* at 24.

152 *Supra* note 33 at 88.

(2) financial institutions must be diligent when lending funds to a borrower whose lands may be encumbered by overriding royalties or other contractual interests.

C. *HUSKY OIL OPERATIONS LTD.* v. *M.N.R.*[153]

The issue in dispute in this case was whether Husky Oil Operations Ltd. ("Husky") would be liable for the amounts due under *The Workers' Compensation Act, 1979*[154] owed by a Husky contractor who subsequently went bankrupt. The case turns on the applicability of a section of the Saskatchewan Act in the face of the federal *Bankruptcy and Insolvency Act*.[155] The case provides a useful review of the developments in the law over the last two decades relating to the jurisdictional conflict between the federal power over bankruptcy and the provincial power over property and civil rights.

1. Facts

Husky entered into contracts with Metal Fabricating & Construction Ltd. ("Metalfab") (the contractor and subsequently the bankrupt) in connection with the construction of the heavy oil upgrader at Lloydminster, Saskatchewan. The Bank of Montreal (the "Bank") had taken a general assignment of book debts from Metalfab for loans advanced to it and Husky was notified of the Bank's security interest and told to pay to the Bank any amounts payable to Metalfab. Metalfab had defaulted in its Workers' Compensation Fund contributions for the employees on its payroll, in the amount of approximately $200,000. The board notified Husky that Husky was liable under s. 133(1) of the Saskatchewan Act as principal in respect of the amounts that Metalfab had not paid to the board. Subsection 133(3) of the Saskatchewan Act permitted Husky to recover those sums from Metalfab by way of set-off. Husky owed approximately $800,000 to Metalfab in respect of holdbacks and contractual debt. These funds were paid into court.

Husky and Metalfab's creditors submitted that the operation of s. 133 of the Saskatchewan Act[156] conflicted with s. 136 of the *Bankruptcy Act*,[157] which sets out the priority of creditors on bankruptcy. Husky argued against the application of s. 133(1) but if this provision was found to be valid, argued that s. 133(3) was also operative and that Husky could setoff the amounts paid to the board from the monies it owed the bankrupt. The Bank, as a principal secured creditor, argued that s. 133(3) should not apply to permit Husky to setoff funds it owed to the board, but that if Husky were not to have any liability to the board then there would be no set-off issue. The Board relied on s. 133(1) to create joint and several liability between Husky as principal and the contractor to claim part of the funds paid into court by Husky.

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153 [1995] 10 W.W.R. 161 (S.C.C.).
154 S.S. 1979, c. W-17.1, s. 133(1)(13) [hereinafter the "Saskatchewan Act"].
155 R.S.C. 1985, c. B-3 [hereinafter *Bankruptcy Act*].
156 *Supra* note 154.
157 *Supra* note 155.

2. Decision

The Supreme Court of Canada split five to four on this decision. Mr. Justice Gonthier, speaking for the majority, held that s. 133 of the Saskatchewan Act, although not *ultra vires* does not apply in a bankruptcy. The combined effect of s. 133(1) and the set-off against the bankrupt's property in s. 133(3) allows the board to recover against the bankrupt ahead of its federally mandated priority in s. 136(1)(h) of the *Bankruptcy Act*, creating an operational conflict. While the provincial law may validly affect priorities outside of bankruptcy, in a bankruptcy there was an operational conflict and s. 133 intruded into the exclusive federal sphere of bankruptcy and went far beyond an incidental and ancillary effect. In the result, the funds paid into Court by Husky became part of the bankrupt's estate and the claim of the Board was limited to its priority under the *Bankruptcy Act.*

In dissent, Justice Iacobucci held that there was no conflict between the provincial and federal legislation. The provincial legislation created a third party guarantee in favour of the board. The set-off provided for in the provincial legislation was also recognized in the federal legislation and would have applied regardless of the assignment of book debts to the Bank. In his view, the board should recover its claim out of the funds paid into Court by Husky and Husky could then setoff that amount against its debt to the bankrupt's estate.

3. Comments

From a constitutional law point of view, both judgments provide a useful summary of the "quartet" of Supreme Court bankruptcy decisions dealing with various provincial legislation each held to be in conflict with the *Bankruptcy Act.* From the perspective of an oil company subcontracting its work to third party contractors, the result is neutral as to liability for Worker's Compensation contributions of the contractor. In any event, holdbacks and compliance certificates should always be used to ensure that the liability for such claims is satisfied by the contractor or out of funds owing to the contractor by the oil company.

D. *RE SHIRLEY*[158]

The issue in this case is the ability of the Crown to recover in bankruptcy a debt created with respect to the costs of environmental clean-up, where the Crown has entered the land of a bankrupt and commenced clean-up operations.

1. Facts

Shirley's trustee in bankruptcy brought a motion to determine whether a claim by the Ontario Ministry of the Environment ("Environment") was a provable expense under the *Bankruptcy Act.*[159] Shirley was involved in the development and manufacture of

[158] (1995), 36 C.B.R. (3d) 101 (Ont. Ct. (Gen. Div.)).

[159] *Supra* note 155.

chemical fertilizers and had contaminated land used to stockpile waste in large volumes in steel and plastic tanks. There had been nine significant spills. The expense of the clean-up was as yet undetermined but would range in the millions of dollars.

Environment had issued an order under the *Environmental Protection Act*[160] ordering Shirley to clean up the property and when Shirley did not comply with the terms of the order, Environment issued a notice of its intention to proceed with the work outlined in the previous notice. Work then commenced on the clean-up operation under the direction of Environment. All this occurred prior to the date on which the petition for a receiving order was issued against Shirley. Thereafter, Environment filed a proof of claim under the bankruptcy and issued an order against the bankrupt under s. 150 of the *Environmental Protection Act* for indemnity and reimbursement of all costs incurred by Environment to clean up the property. The opposing creditor argued that the order did not crystallize until after the date of the bankruptcy. It also argued that the decision in *Panamericana* v. *Northern Badger Oil*[161] supported its position as the status of the debt at the time of the bankruptcy was unclear. As well, it argued that the extent of the debt was too remote to be recoverable in bankruptcy and the form of notice given to the debtor was not definitive because at no time did Environment indicate its intention to exercise its option was a certainty.

2. Decision

Kennedy J. of the Ontario Court of Justice (General Division) held that prior to the issuance of the receiving order, Environment had entered the land and was actively engaged in clean-up. When Environment issued its notice, the effect was to secure a lien on the realty with the authority of a binding court order. The *Panamericana* case was distinguished on the basis that in that case the Crown agency under the *Waste Management Act*[162] had elected to issue an order requiring the receiver of a bankrupt to seal seven abandoned oil wells. Had the authority chosen to exercise its option to enter the lands of the bankrupt and seal the wells itself, under the *Oil and Gas Conservation Act*,[163] then the costs would have become a debt payable to the board and provable in bankruptcy. Reference was also made to the *Lamford* decision[164] where Harvey J. held that because there was not a debt-creating provision in the *Waste Management Act* in British Columbia, the Crown could not be considered a creditor under the *Bankruptcy Act*.

3. Comments

Provided the relevant legislation creates a debt with respect to environmental clean-up, the Crown will be able to recover in a bankruptcy by entering the land and commencing clean-up operations, assuming all other requirements of proving the debt

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160 R.S.O. 1990, c. E-19.

161 (1991), 8 C.B.R. (3d) 31 (Alta. C.A.) [hereinafter *Panamericana*].

162 R.S.B.C. 1992, c. 25.

163 R.S.C. 1985, c. O-7.

164 *Re Lamford Forest Products Ltd.* (1991), 10 C.B.R. (3d) 137 (B.C.S.C.).

in a bankruptcy are satisfied. This course of action will overcome the roadblock experienced in the *Panamericana* case.

X. ABORIGINAL OIL AND GAS

A. *BLUEBERRY RIVER INDIAN BAND* v. *CANADA*[165]

This case, which is commonly known as the *Apsassin* case, deals with a claim by two Indian bands against the Crown for alleged breaches of fiduciary duty in regard to the Crown's dealings with the oil and gas rights attached to their reserve. These interests were surrendered to the Crown in the 1940s.

1. Facts

The appellants are two Indian Bands who had formed a single band until 1977. The Crown had established a reserve for that band in 1916. In 1940, after an oil company had expressed interest in surveying for oil on the reserved property, the band surrendered the mineral rights to the Crown "in trust to lease." In 1945, the Crown was under pressure to provide farm land for returning veterans. That year the band agreed to surrender the entire reserve to the Crown "in trust to ... sell or lease." The Department of Indian Affairs ("Indian Affairs") sold the land, including the mineral rights, to the Director of the *Veterans Land Act* (the "Director") in 1948 for $70,000. Indian Affairs used the money to purchase land for new reserves that were closer to the band's trap lines. These new reserves did not include mineral rights. The Director sold the land, including the mineral rights, to veterans.

Later in 1948, following the discovery of gas nearby, an oil company became interested in exploring for oil and gas on the reserve lands. The oil company approached Indian Affairs, who together with the Director, determined that the Director held the mineral rights, since those rights had not been reserved from the transfer. It was later concluded that the failure to reserve the mineral rights was inadvertent. The bands brought the action in 1978 for damages, alleging that the Crown allowed the band to make an improvident surrender and disposed of the land at less than its value and wrongly permitted the transfer of the mineral rights.

The trial judge held that the sale of the surface rights was at an undervalue but otherwise dismissed the action. An appeal and cross-appeal were dismissed by the British Columbia Court of Appeal.

2. Decision

Although unanimous in its conclusion, the Court split on its approach to the minerals rights issue.

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[165] (1995), 130 D.L.R. (4th) 193 (S.C.C.).

Justice Gonthier writing for the majority (La Forest, Sopinka and L'Heureux-Dube J.J.) held that it was not necessary to consider the 1940 surrender of the mineral rights since the legitimacy of the surrender was not an issue. He held that the 1945 surrender included the mineral rights, not because of technical common law rules governing property transfer, but because it was the intention of the band. Gonthier J. stated that the law treats aboriginal people as autonomous actors with respect to the acquisition and the surrender of their land and therefore aboriginal intention will take precedence over common law rules of property. The band's intention was clear from the fact that the surrender document stated that it surrendered the "reserve" and s. 2(j) of the *Indian Act*[166] defines "reserve" as including the minerals in it. Although the surrender of Indian lands does not meet all the traditional requirements for a common law trust, the 1945 surrender could be best regarded as a variation of a "trust" in Indian land since it subsumed the 1940 surrender and extended it.

Since the Crown took on the obligations of a trustee, it was under a fiduciary duty to deal with the land in the best interest of the band. The 1945 surrender gave the Crown a discretion to sell or lease. Using this discretion it could have sold the surface rights and continued to lease the mineral rights. Retaining the mineral rights and continuing to lease them for the benefit of a band had been the Department's long standing policy because it was thought to be in the best interest of the aboriginal peoples. For that reason, the Crown was under a fiduciary duty to reserve the mineral rights when it sold the surface rights. Failure to do so was a breach of its fiduciary duty.

McLachlin J. in a concurring opinion (with Major and Cory JJ.) differed from Gonthier J. with respect to the 1940 surrender of the mineral rights. McLachlin J. held that the 1940 surrender under s. 54 of the *Indian Act* made the Crown a fiduciary of the mineral rights for the benefit of the band. Under the terms of the surrender the Crown could only lease the mineral rights. The effect of the 1940 surrender was to remove the mineral rights from the reserve. Thus, when the band surrendered its interest in reserve in 1945, it could only surrender what it still had, namely the surface rights. Once a reserve or a portion of a reserve has been surrendered to the Crown it becomes "Indian land" as defined in s. 2(e) of the *Indian Act*. The definition of "reserve" in s. 2(j) includes only land that has not been surrendered. Section 50 of the *Indian Act* and the regulations showed that it was possible to surrender mineral rights without surrendering the surface rights.

Although the *Indian Act* did not formally provide for a re-surrender, this could be done administratively by means of revocation of an earlier surrender, after which the reconstituted reserve could be surrendered again on new terms. The 1945 surrender did not constitute revocation of the 1940 surrender. Thus, the mineral rights could not be surrendered again in 1945. In view of the detailed provisions of the *Indian Act* and the provisions of the 1940 surrender, it was improper to base a decision on the parties intention in 1945. Even it were proper, the evidence did not establish an intention to surrender the mineral rights in 1945.

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166 R.S.C. 1985, c. I-5 [hereinafter *Indian Act*].

McLachlin J. held that the transfer of the mineral rights from Indian Affairs to the Director in 1948 was a breach by the Crown of its fiduciary duty. The transfer breached the 1940 surrender on its terms. Even if the 1945 surrender had applied, the transfer of the mineral rights would have breached the obligation under that surrender to lease or sell the land in the best interests of the band. In 1948, the Crown was aware of the potential value of minerals in Indian reserves generally and should have been aware of the value of the minerals in this reserve. The Crown was under a duty to deal with the mineral rights in the same way as a reasonable business person handling his own affairs. A reasonable business person would not give away a potentially valuable asset.

The Court was unanimous in holding that part of the claim was not barred by the thirty year ultimate limitation period in s. 8 of the *Limitation Act*.[167] Section 64 of the *Indian Act* conferred a right on the Crown to revoke any erroneous sale or lease and, since it breached its fiduciary duty, it was bound by a continuing duty to remedy the breach. The duty to revoke the transfer of the mineral rights to the Director arose when the Indian Affairs came into possession of information from which a reasonably prudent person could have determined that the mineral rights had value and had been erroneously sold to the Director. As a result, the thirty year limitation period barred the claim only on those minerals rights which had been sold from the Director to individual veterans (as *bona fide* purchasers for value) outside the thirty year period.

3. Comments

This case is likely to be influential in the area of Indian oil and gas law as there are a number of similar claims in the process of being advanced by various Indian bands.[168] The case establishes that the Crown owes a fiduciary duty to Indian bands with respect to mineral rights which have been surrendered to the Crown. The Court was unanimous in holding that the Crown must deal with mineral rights in the same manner as a reasonably prudent business person dealing with his own affairs. The fiduciary obligation on the Crown and s. 64 of the *Indian Act* impose a special burden on the Crown to take steps to remedy inadvertent breaches of fiduciary duty once the Crown comes into possession of information from which it could reasonably deduce its error.

Gonthier J.'s reliance on the presumed intention of the band is problematic as it appears to ignore the long-established principle that mineral title can be severed from surface title. He also overlooks the definition of "reserve" in the *Indian Act* which specifically excludes any portion of a reserve which has already been surrendered. There is a highly detailed regulatory scheme in place with respect to Indian oil and gas interests, which has now become the subject of a separate act, the *Indian Oil and Gas Act*.[169] This scheme is based upon the ability of a band to sever mineral rights from

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167 R.S.B.C. 1979, c. 236.

168 See *e.g. Enoch Band of the Stony Plain Indians* v. *Canada*, [1996] F.C.J. No. 391 (Q.L.) (F.T.D.); *Samson Indian Band* v. *Canada*, [1996] F.C.J. No. 1158 (Q.L.) (F.T.D.); *Ermineskin Band* v. *Canada*, [1995] F.C.J. No. 1254 (Q.L.) (F.T.D.).

169 R.S.C. 1985, c. I-7.

the surface title in the reserve and to deal separately with those rights. The reasoning of McLachlin J., which pays deference to the split title and the regulatory scheme and which applies the well established legal principle of *nemo dat quod non habet*, seems preferable in this regard.