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 cases in areas such as contracts, land leases and titles, fiduciary duties, tax, the environment, torts, surface rights, off-shore drilling, creditors rights and administrative law. The authors also look at three cases for which leave to appeal to the Supreme Court of Canada was requested.

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I. INTRODUCTION

In the past year, there have been numerous Canadian decisions pertaining to oil and gas law on a number of interesting topics. We placed emphasis on those decisions which, in our opinion, are of the greatest significance to oil and gas lawyers. Similar to last year, issues respecting fiduciary duties were at the forefront, with arbitration and other matters running a close second.

Due to the large number of cases, the decisions outlined below are neither a complete list of all relevant cases, nor is each case a complete brief of the issues discussed in the decision. Therefore, our case summaries should not be relied on in place of the readers' review of the decisions themselves. Further, we also include the usual disclaimer that the opinions expressed are those of the writers only and not of Petro-Canada or the Canadian Petroleum Law Foundation.

II. CONTRACTS

A. *ALTASTEEL LTD.* v. *INVERNESS PETROLEUM LTD.*[1]

A contract between Stelco (parent of AltaSteel Ltd.) and Pan Continental Oil Ltd. ("PanCon") (subsidiary of Inverness Petroleum Ltd.), for the sale and delivery of gas to Stelco's manufacturing plant, contained a pricing arrangement that was based on the monthly Alberta Border Price ("ABP"). For those months where the ABP was not in effect, the agreement stated that the legislated price was to be used, and when the legislated price was not in effect the Deemed Border Price ("DBP") would be used. The contract also contained provisions for mandatory arbitration to settle disputes concerning billing and payment, and voluntary arbitration for general disputes.

As a consequence of the deregulation of gas markets and prices in 1986, the ABP became obsolete and the legislated price no longer existed, leaving only the DBP to determine pricing in the contract. The DBP was calculated as the average well-head price received by producers in Alberta. Stelco and PanCon could not agree on how to determine the average well-head price and negotiations ensued. The end result was an amended contract that identified the DBP as the price contracted between Western Gas Marketing Ltd. ("Western") and Union Gas Ltd. ("Union") for "Block A" customers.

In August 1991, PanCon was amalgamated with a subsidiary of Inverness Petroleum to form Inverness Energy. Inverness Petroleum acted as its authorized agent in respect of gas contracts, including the contract between Stelco and PanCon. In June 1992, Stelco incorporated AltaSteel, a wholly owned subsidiary, and transferred its manufacturing plant to AltaSteel, as well as its contract with PanCon. Neither Inverness Energy nor Inverness Petroleum consented to the assignment of AltaSteel as required under the contract between Stelco and PanCon.

Effective November 1, 1993, the gas purchase contract between Western and Union was replaced by a new contract that eliminated Block A gas pricing. Inverness informed AltaSteel that because the fundamental pricing term of their amended contract could not be determined, Inverness considered the contract to have ended. AltaSteel proposed to invoke the arbitration provisions but Inverness took the position that since the contract was at an end, the arbitration provisions were not available.

The judgment in this case concerned AltaSteel's application for an injunction to compel Inverness to supply the gas until the contract dispute had been settled and a stay of the proceedings pending arbitration. AltaSteel also sued for specific performance for mandatory arbitration.

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1 (1994), 24 Alta. L.R. (3d) 212, 161 A.R. 138 (Q.B.).

The Court dealt with several issues, the first of which was whether there had been a valid assignment of the contract from Stelco to AltaSteel. The original contract between Stelco and PanCon stated that it would be binding only on the parties, their successors and approved assigns. The Court found that AltaSteel was a wholly owned subsidiary, with a separate legal identity, and not a "successor" corporation which is one that takes on the rights and burdens of a previous corporation. In addition, AltaSteel could not be considered an "approved assign" as there was no evidence of an approval from Inverness. For these reasons the assignment was held to be invalid. However, because Inverness supplied gas to AltaSteel and accepted payment from it after the plant had been transferred by Stelco, the Court held that Inverness had not asserted its right to withhold consent to the assignment of AltaSteel, which led AltaSteel to assume that the strict rights under the contract would not be enforced. Inverness was therefore estopped from relying on the "binding" clause of the contract.

The second issue addressed by the Court was which arbitration provision applied to the dispute between the parties. The contract contained two separate arbitration provisions. One was located under the specific heading of "billing and payment" and provided for mandatory arbitration in the event of a dispute. The second provision was located in a general arbitration section and stated that arbitration was voluntary and would not preclude a party from exercising other remedies such as litigation. Inverness contended that the dispute concerned pricing, as opposed to billing and payment, and therefore fell under the general arbitration provision. The Court agreed with Inverness and stated that the issue of pricing was a fundamental term of the contract, not an administrative item such as billing and payment. In the Court's view, pricing went to the question of whether a contract was in existence, whereas billing and payment were details affecting the operation of the contract. The Court held that arbitration was not binding on Inverness and therefore refused a stay of the proceedings.

The final issue concerned the injunctive relief sought by AltaSteel. The Court found that AltaSteel's affidavit contained little of the evidence necessary to establish a strong *prima facie* case that it would succeed at trial. The Court went on to remark that even if there had been a *prima facie* case, it would not have granted the injunctive relief because there was no irreparable harm likely to occur as a result of refusing the application.

The result was that AltaSteel's application for injunctive relief, specific performance and a stay of proceedings was dismissed.

B. *JOMAR ENGINEERING LTD.* v. *LOCKWOOD RESOURCES LTD.*[2]

The dispute in this case involved the interpretation of a participation and trust agreement ("the Agreement") between the plaintiff, Jomar Engineering Ltd. ("Jomar"), and the defendant, Lockwood Resources Ltd. ("Lockwood"). The agreement provided:

[2] [1995] A.J. No. 8 (Q.B.) (QL).

> That the participant [Jomar] by paying 15% of the drilling costs, completion costs and equipping costs of the said *test well* ... shall earn 13.5% to payout and 6.0% after payout of the working interest in the *production spacing unit* and 6% interest earned in the applicable remainder of the farmout lands... [emphasis added].

The test well was drilled at 8-20-28-18 W4M. It went through the Mannville Basal Quartz zone down to the Banff Formation, but no gas was found and the well was plugged back to the Belly River zone. The defendant decided to drill a second well on the farmout lands at 11-20-28-18 W4M. All subsequent invoices and cheques sent by the defendant relating to costs and production of the second well were issued according to the plaintiff's 6 percent interest.

The plaintiff claimed, among other things, that it did not receive the benefit of 13.5 percent participation in section 20. The question before the Court was whether the Agreement allowed for the plaintiff to earn 13.5 percent before payout in just the test well or in all of section 20.

The Court noted that the term "production spacing unit" ("PSU"), used in the Agreement, had previously been defined in the *Oil and Gas Conservation Act*[3] but that the subsection had been repealed. In order to determine the meaning or usage of the term by the persons involved in the petroleum industry, the Court heard expert testimony from two witnesses. That testimony established that a PSU is an area allocated to a well from a specific zone and is therefore well-specific and zone-specific. In addition, there can only be a PSU when there is production in the specific zone. The Court was satisfied upon this evidence that the PSU for the test well was the Belly River zone and the PSU for the second well was the Basal Quartz zone. The agreement between the parties indicated that the plaintiff earned 13.5 percent to payout only in the Belly River zone and not in all or any of the other zones. The plaintiff's claim for damages in this regard was dismissed.

C. *PANCANADIAN PETROLEUM LTD.* v. *HUSKY OIL OPERATIONS LTD.*[4]

PanCanadian Petroleum Ltd. ("PanCanadian") granted two leases to Husky Oil Operations Ltd. ("Husky") — a shallow rights lease and a mineral lease — both of which had twenty-five-year terms that ended January 2, 1992. Each lease had an habendum clause that provided for continuation of the lease as long as there was production of the leased substances, and each lease contained a renewal clause that gave the lessee the option for a "renewal of the leased substances in the said lands for a further primary term of 25 years."

On November 13, 1991, Husky requested a renewal of both leases pursuant to the renewal clauses. PanCanadian refused the request claiming that the renewal clauses

[3] R.S.A. 1980, c. O-5, s. 1(1)(r), as rep. by S.A. 1991, c. 26 [hereinafter *Conservation Act*].

[4] (1994), 163 A.R. 367 (Q.B.).

violated the rule against perpetuities. Although the *Perpetuities Act*[5] has modified the rule, pursuant to s. 25, the two leases were not affected as they predated the *Act*.

The Court held that, by the terms of the renewal clauses, the leases could be renewed forever and they therefore offended the rule against perpetuities. However, since the shallow rights lease had continued production, it met the condition in the habendum clause for continuation of the lease. Renewal of such a lease was therefore not required and it was held to continue in force. There was no continued production under the mineral lease so the only option for renewal for such lease was the renewal clause. This right of renewal was rendered unenforceable because of the rule against perpetuities and the lease did not continue.

The Court rejected Husky's argument that the right of renewal was a vested interest to which the rule against perpetuities did not apply. It looked at Morris & Leach's *Rule Against Perpetuities*[6] where a vested interest was defined as one where "the persons to take it are ascertained and there is no condition precedent attached to the remainder other than the termination of the prior estate." Within the shallow rights lease and the mineral lease, the conditions for the renewal were timely notice and payment of prescribed fees. Husky argued that these were not conditions precedent but rather conditions subsequent that went to the defeasibility and not to the vesting of the interest, but in the Court's view they were conditions precedent.

Husky also cited *Guardian Realty* v. *John Stark & Co.*[7] where it was held that an absolute covenant to renew a lease at the lessee's option was not a future interest arising upon the fulfilment of a condition precedent, but was a present interest annexed to the land at the inception of the lease. The Court distinguished this case as it dealt with a landlord-tenant relationship and a lease which contained an absolute covenant to renew.

The Court also rejected Husky's argument that even though the renewal provisions offended the rule against perpetuities, they should be entitled to specific performance because of the "further assurances" clause in each of the leases. The clauses read as follows:

> The lessor and lessee hereby agree that they will each do and perform all such acts and things and execute all such deeds, documents and writings and give all such assurances as may be necessary to give effect to this lease and all covenants herein contained.

Husky argued that these clauses created a personal covenant. The Court's view was that construing a covenant as a personal contract cannot be used to avoid the rule against perpetuities, otherwise the rule would effectively be abolished. In addition, the Court stated that the rule operates notwithstanding the intention of the parties.

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5 R.S.A. 1980, c. P-4.

6 2d ed. (London: Stevens & Sons Ltd., 1962) at 1.

7 (1922), 64 S.C.R. 207.

D. *RELANE HOLDINGS LTD.* v. *SUNARCTIC RESOURCES LTD.*[8]

Relane Holdings Ltd. ("Relane"), whose principal officer was Ron Lane and whose primary business was trucking, acquired an interest in an oil well known as "Flat Rock well." Sunarctic Resources Ltd. ("Sunarctic"), whose principal officer was Sidney Chapple, owned "Rigel well." In June 1992 the two companies agreed they would be equal co-owners of the two wells. Pursuant to that agreement, Relane transferred its interest in the Flat Rock well to Sunarctic. It was also agreed that a third company, Sunarctic Treating & Disposal ("Sunarctic Treating"), would be incorporated to hold the trucking and related equipment assets, and to act as the operating company of the venture, with shares being held equally by Relane and Sunarctic. Chapple was responsible for the incorporation of that company.

The policy of the Ministry of Energy, Mines and Petroleum Resources ("the Ministry") required that a well authorization applicant who had not operated in British Columbia or who had no wells or production assets on record must supply financial information to the Ministry for approval. Relane lacked the prior well requirements and so the application was submitted in Sunarctic's name and authorization for the well was granted. The Flat Rock well commenced production in the summer of 1992.

In the fall of 1992, Lane and Chapple had a falling out and an attempt at negotiations failed. Sunarctic continued production of the well through October 1993, to the exclusion of Relane. Relane commenced an action seeking return of the Flat Rock well, damages, and an accounting by Sunarctic. In its defence, Sunarctic claimed that it was a term of its agreement with Relane that if they could not work harmoniously together then Relane would surrender its interest in the well to Sunarctic.

The issue before the Court was whether there had been any agreement between the parties regarding the consequences of a failure of the joint enterprise. The Court found that the written agreement contained no term to that effect and furthermore that Lane and Chapple had not discussed the topic at any time. In addition, the Court found that Sunarctic had not transferred an equal interest in the Rigel well to Relane; it had not transferred its equipment assets to Sunarctic Treating; and the shares in Sunarctic Treating had not been equally issued. In the opinion of the Court, Sunarctic repudiated the agreement by failing to do these things within a reasonable amount of time. In the alternative, the Court stated that if the time was reasonable, then Sunarctic repudiated the agreement by continuing to operate the wells to the exclusion of Relane. The result was that Relane was entitled to the relief it sought against Sunarctic, namely a declaration that Relane was the owner of the well and the transfer of the well into Relane's name.

With regard to the transfer of the well, the Court looked at the *Petroleum and Natural Gas Act*[9] which required the consent of the official designated by the *Act* for the transfer of well authorizations. The Court did not have the information before it to

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[8] [1994] B.C.J. No. 1889 (B.C.S.C.) (QL).

[9] R.S.B.C. 1979, c. 323.

decide whether the consent would be granted and therefore referred the issue to the Ministry. In the event the well could not be transferred, the Court stated that damages would be assessed accordingly.

E. *ROBERT LEMMONS & ASSOCIATES LTD.* v. *GANNON BROS. ENERGY LTD.*[10]

Gannon Bros. Energy Ltd. ("Gannon") and Robert Lemmons & Associates Ltd. ("Lemmons") entered into a written agreement to drill two wells, with each party retaining a 50 percent interest. The agreement included the standard Canadian Association of Petroleum Landmen ("CAPL") operating procedure;[11] however, the judgment does not specify which version was used. Gannon acted as operator under the agreement and Lemmons as engineer and consultant.

The first well, located at 11-5-2-4 W2, was moderately successful and the parties went ahead with the second well at 9-5. Initially, it appeared that the second well was not promising and the parties agreed they should abandon. Gannon changed its mind however, and in a telephone conversation on September 3, 1988, it induced Lemmons to continue participating in the well by proposing a joint ownership of equipment located at Gannon's 1-21 well. In return for this interest, Lemmons would be obliged to share the expense of abandoning 1-21. Lemmons agreed to the proposal and the well casing was set for the 9-5 well on September 4. On September 19, however, Gannon suggested to Lemmons that it pull tubing from the 1-21 well to be used in the 9-5 well and then return it to 1-21 for abandonment purposes. Prior to this, Lemmons had become aware of the fact that Gannon did not have approval for abandonment of the 1-21 well from the co-owners. Under those circumstances, Lemmons felt it would be unethical to pull the tubing from the 1-21 well and, in addition, it felt it would not be economical. Lemmons found the proposal unacceptable and, on September 21, Lemmons' lawyer sent a letter to Gannon stating that Lemmons would not participate in the completion of the 9-5 well because Gannon had breached the equipment agreement.

The relationship between the parties had begun to sour early on when Gannon became annoyed with the amount of Lemmons' invoices. The deterioration continued when Gannon discovered that Lemmons had sold off most of its interest to partners. On October 4, 1988, the 9-5 well became a producer, resulting in renewed controversy between the parties. Gannon subsequently claimed that Lemmons' letter of September 21 was an abandonment of its interest in the well, making Gannon an independent operator of the well as envisaged by the CAPL operating procedure. Lemmons refuted this and claimed that Gannon breached their oral contract made on September 3,

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10 [1995] S.J. No. 178 (Q.B.) (QL).

11 The CAPL Operating Procedure is published in Calgary by the Canadian Association of Petroleum Landmen. Its purpose is to define the relationship of two or more parties holding a joint interest in oil and gas property. It is currently in its fifth version (published 1990) with prior publications in 1969, 1971, 1974 and 1981.

regarding the equipment at the 1-21 well, which forced Lemmons to withdraw from participation.

The case raised several issues, including allegations of negligence in completing one well, abandonment of interest in the second well, and enforceability of an account rendered by an unregistered engineer.

To determine whether Lemmons had abandoned its interest in the well, the Court looked at the CAPL operating procedure. Clause 903 referred to the situation where some, but not all, of the parties elect to set production casing and complete a well. In that event, the clause stated that it shall be considered an independent operation. Clause 903 engaged clause 1007 which outlined the penalties that apply between the participating parties and the non-participating parties. It provided for the retention of the possession of the well by the participating party until the gross proceeds from production reached a certain level.

In addition to the CAPL operating procedure, the Court looked at the September 21 letter from Lemmons to Gannon. The Court considered that the letter was drafted by a lawyer and contained very precise wording to the effect that Lemmons "would not participate in the completion of the 9-5 well" and would "not bear any of the costs of completing this well." In the Court's view, if Lemmons had wanted to surrender its interest it would have clearly stated as much, rather than simply declining participation in the completion of the well.

The Court held that Lemmons did not abandon its interest in the 9-5 well. Instead, it merely opted out of participation in the completion of the well. Pursuant to clause 903 of the CAPL operating procedure, Gannon was held to have completed the 9-5 well as an independent operation and was entitled to the penalties in clause 1007.

The next issue was the claim by Gannon that Lemmons was negligent in its completion of the 11-5 well. Gannon's complaint concerned the acidization and fracturing treatments administered to the well. Through expert testimony, the Court concluded that there was no evidence of negligence on the part of Lemmons. In addition, the Court commented that it was doubtful there had been reliance by Gannon to the extent necessary to succeed in a negligence claim, as Gannon itself had extensive experience in drilling and was not at the mercy of Lemmons' recommendations.

The Court also looked at the issue of whether Lemmons' bills to Gannon were enforceable considering that Lemmons' (the man, and proponent of Lemmons, the company) registration as an engineer had expired. Lemmons chose not to renew his personal membership as a professional engineer at the end of 1987, and as of July 8, 1988, he was no longer entitled to practice. In addition, the engineering authorization for Lemmons' corporation expired on December 31, 1986, and was not renewed. Lemmons continued to invoice Gannon after these expiry dates.

The *Engineering Profession Act*,[12] in s. 51, prohibits unregistered persons from engaging in professional engineering. The penalty for doing so is a fine in summary conviction proceedings. In addition, the section states that the unregistered person "shall not be entitled to recover any fees, rewards or disbursements for any service rendered by him as a professional engineer or in professional engineering." The *Act* also provides sanctions in s. 53 against unauthorized corporations. That section does not specifically prohibit recovering fees as it does for "persons" practicing engineering, but the case law has held that accounts rendered for such services would be unenforceable.

The Court held that neither Lemmons nor his company could enforce payment of the accounts that were rendered after the expiry dates of the engineering certificates. Lemmons argued that a portion of the work he performed for Gannon was non-engineering and he should be able to recover his fees for that work. The Court examined the wording of Lemmons' invoices and, although it was reluctant to compensate an unlicenced engineer on a *quantum meruit* basis, it found that justice dictated there should be an allowance for the non-engineering endeavours. Of the $26,800 in unpaid invoices, the Court awarded Lemmons $11,000.

After discovering the registration defect, Gannon also tried to recover funds already paid to Lemmons' corporation for services rendered from the time the corporation's registration was expired. The Court dismissed this claim for the following reasons: at the time of payment Gannon was satisfied with the work and it paid voluntarily; this was not a case of the corporation trying to enforce payment of tainted accounts; Robert Lemmons was properly certified at the time so the corporation had a licenced engineer behind it; and the issue was raised many years after the fact.

Finally, Gannon asked that the Court rescind the original drilling contract between it and Lemmons because, among other things, Lemmons had made fraudulent representations to obtain its 50 percent interest. The Court stated that in order to exercise its discretion to grant rescission, Gannon had to prove that the parties could be restored to their original positions and that there was a fundamental breach of contract.

With regard to Lemmons' misrepresentations, Gannon claimed that it was of the understanding that Lemmons would be the sole owner of its interest. There was no evidence before the Court that Lemmons had made any representations to Gannon about not having partners. The Court looked at clause 2401 of the CAPL operating procedure which stated:

> The party wishing to make the assignment, sale or disposition shall notify the other parties and obtain their written consent, which shall not be unreasonably withheld.

Although Lemmons did not abide by this clause, the Court found that Gannon itself had disposed of 8 percent of its interest without requesting Lemmons' consent. The Court also noted that Gannon had struck out the clause of the CAPL Operating Procedure that

[12] R.S.S. 1978, c. E-10.

called for a right of first refusal, which was an indication that it did not want to interfere with disposition to partners. The Court disposed of the complaint by finding that either party would have been unreasonable if it had withheld consent. The Court also stated that even if Lemmons' disposition to partners was invalid, it would not result in rescission of the contract. The result was that the Court could not find a fundamental breach of the contract and dismissed Gannon's claim for rescission.

F. *TWO FORTY ENGINEERING LTD.* v. *PLATTE RIVER RESOURCES LTD.*[13]

The issue in this case dealt with a right of first refusal as it applied to a sale of a property by Platte River Resources Ltd. ("Platte River") to Two Forty Engineering Ltd. ("Two Forty"). The dispute centred around the interpretation of an operating agreement that incorporated the 1974 CAPL operating procedure.

Lochfayne Resources Ltd. ("Lochfayne") entered into a farmout agreement with Shell Canada Resources Ltd. ("Shell"). Clause 10 of the farmout agreement included a right of first refusal granted to Shell with respect to any transfer made by Lochfayne. With the approval of Shell under its right of first refusal, Lochfayne assigned all of its interest in the lands to four companies, namely Platte River, NGL Supply Ltd., Copperhead Oil Company Ltd. and Baton Rouge. To continue operations on the lands following that assignment, Lochfayne and the four companies entered into an operating agreement which incorporated the 1974 CAPL operating procedure.

In 1993, substantially all of the assets of Platte River were sold to Two Forty. Baton Rouge, as a party to the operating agreement, submitted that it had a right of first refusal to Platte River's interest pursuant to the CAPL operating procedure.

The provisions of the operating agreement that dealt with rights of first refusal were contained in article 11.01. Those provisions recognized Shell's right of first refusal as well as a right of first refusal between the parties to the operating agreement. The relevant provisions of article 11.01 were as follows:

> 11.01
>
> ...
>
> (b) A party may transfer all or part of its interest in all of the Farmout lands only if it:
>
> (i) first offers such interest to Shell pursuant to clause 10 of the Farmout Agreement as if such party were a party to the Farmout Agreement in the place and stead of Lochfayne; and
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> (ii) if Shell elects not to purchase the interest, then the party desiring to transfer its interest must then comply with clause 2401 B of the Operating Procedure.

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[13] (1995), 26 Alta. L.R. (3d) 183 (Q.B.).

The opening portion of clause 2401 of the CAPL operating procedure stated that a party cannot assign, sell or dispose of an interest in joint lands without complying with paragraphs A or B. Paragraph B contained the right of first refusal for the other parties. However, the opening portion of clause 2401 also stated that it was subject to clause 2402 which provided for certain exceptions as follows:

> 2402 EXCEPTIONS TO CLAUSE 2401 - clause 2401 shall not apply in the following instances, namely:
>
> ...
>
> (c) An assignment, sale or disposition made by the assignor of all, or substantially all, or of an undivided interest in all, or substantially all of its petroleum and natural gas rights in the province, state or territory where the joint lands are situated.

The parties agreed that the sale to Two Forty constituted all of Platte River's interest and so the dispute boiled down to the proper interpretation of the incorporating reference to clause 2401 B of the CAPL operating procedure in article 11.01(b)(ii) of the operating agreement. Baton Rouge argued that the language of the agreement should be given its precise literal and ordinary meaning, thereby incorporating only 2401 B and not its opening portion. Two Forty argued that the agreement should be interpreted so as to reconcile all of the terms and allow the entire contract to be read as a whole.

The Court considered two approaches to interpretation of the contract, both of which supported the final decision that the sale of Platte River's interest was not subject to a right of first refusal. The first approach was to give the words of the provision their plain and ordinary meaning. The incorporation of clause 2401 B was plain and straightforward and the Court held that to incorporate the clause without its opening portion would require specific wording to that effect.

The second approach the Court looked at was one put forth by LaForest and McLachlin JJ. in *BG Checo International Limited* v. *British Columbia Hydro and Power Authority* as follows:

> It is a cardinal rule of the construction of contracts that the various parts of the contract are to be interpreted in the context of the intentions of the parties as evident from the contract as a whole... Where there are apparent inconsistencies between different terms of a contract, the court should attempt to find an interpretation which can reasonably give meaning to each of the terms in question.[14]

Following this rule of construction, the Court found that the apparent differences between article 11.01 of the operating agreement and clause 2401 of the CAPL operating procedure could be reconciled in the context of clause 10 of the farmout agreement, which essentially offered the same exception to a right of first refusal as that found in clause 2402. The incorporation of the whole of the CAPL operating procedure gave it the same scope as the farmout agreement, and under that

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[14] [1993] 1 S.C.R. 12, [1993] 2 W.W.R. 321 [hereinafter *BG Checo*].

interpretation the parties had the same rights of exception prior to any rights of first refusal taking effect.

G. *ATCOR LTD.* v. *CONTINENTAL ENERGY MARKETING LTD.*[15]

This case, though specifically relating to natural gas purchase contracts, is of significance to show the importance of properly drafting *force majeure* provisions in any contract.

The plaintiff, Atcor Ltd. ("Atcor"), entered into a letter agreement with the defendant, Continental Energy Marketing Ltd. ("Continental"), whereby Atcor would supply, and Continental would purchase, certain volumes of natural gas for a specified time period. The deliveries of natural gas were required to be delivered by Atcor off the NOVA Corporation of Alberta ("NOVA") pipeline system to certain TransCanada PipeLines Limited ("TCPL") facilities downstream of Empress, Alberta. Such volumes would then be transported by Continental on the TCPL pipeline system to various destinations.

During the term of the agreement, various compressor breakdowns, pipeline repairs and pipeline connections occurred on the NOVA system, resulting in the partial curtailment by NOVA of firm transportation service provided to Atcor and other firm service shippers at Empress. NOVA did not declare *force majeure* in respect of such curtailments. In this regard, NOVA was recognized as having the right to curtail firm service without making such a declaration. In the agreed statement of facts prepared by the parties, the compressor breakdowns, pipeline repairs and pipeline connections resulting in the curtailments were recognized as being outside the control of Atcor and which could not be overcome by the exercise of due diligence by Atcor.

By reason of the NOVA curtailments, Atcor curtailed a portion of its firm service obligations at Empress. Important to note is that Atcor reduced deliveries to its customers only to the extent of the NOVA curtailments. Further, Atcor reduced or ceased deliveries to Continental under the agreement after it had first reduced or ceased deliveries under its interruptible supply contracts. Atcor, for each reduction or cessation of deliveries to Continental, gave to Continental a *force majeure* notice and, as soon as possible after NOVA's service problems were remedied, a notice that supply would be resumed. Such notices were required under the agreement. Continental did not curtail or claim *force majeure* to its purchasers of gas in response to Atcor's *force majeure* notices, but instead contracted for alternative deliveries of gas to such purchasers at prices in excess of the price contracted for under the agreement.

Atcor applied to the Court for a determination of its liability to Continental under the agreement. Atcor contended that it was entitled to rely on the *force majeure* clause in the agreement and was not liable for the failure to supply gas. On the other hand, Continental argued that Atcor could have overcome the NOVA curtailments by purchasing replacement gas or allocating its available supply.

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15 [1995] 1 W.W.R. 137, 161 A.R. 81 (Q.B.) [cited to W.W.R.].

The relevant portions of paragraph 9 of the agreement which were in issue are as follows:

9. FORCE MAJEURE:

Subject to the other provisions of this paragraph, if either party to this Agreement folio [*sic*] 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 not to be a breach of such covenants or obligations.

(a) For the purposes of this Agreement, the term "*force majeure*" shall *mean* ... breakages of or accidents to plant, machinery or lines of pipe, hydrate obstructions of lines of pipe,... pipeline connections, pipeline repairs and reconditioning, ... any acts or omissions (including failure to take gas) of a transporter of gas to or for Seller which is excused by any event or occurrence of the character herein defined as constituting *force majeure*, ... not within the control of the party claiming suspension and which, by the exercise of due diligence, such party is unable to overcome."

(b) Neither party shall be entitled to *force majeure* benefits:

— to the extent that the failure was caused by the party claiming suspension having *failed* to remedy the condition, and to resume the performance of such covenants or obligations with reasonable dispatch; ... [emphasis added].[16]

Deyell J. stated that the *force majeure* provisions were applicable and Atcor was not liable to deliver gas to Continental to the extent of the NOVA curtailments.

The first issue the Court considered was whether Atcor's "failure" to deliver gas to Continental was an event of *force majeure* as defined in subparagraph 9(a) of the agreement. As discussed above, Continental argued that Atcor, by the exercise of due diligence, could have overcome the NOVA curtailments by purchasing replacement gas or allocating its available capacity. Deyell J., when interpreting paragraph 9 of the agreement stated:

It is the operative clause which determines whether there is a duty on the seller to purchase replacement gas or allocate supply. With careful wording, the parties can change this and impose the obligation anywhere in the contract.[17]

Also interesting to note is that the Court made a distinction between the word "failure" used in the agreement and the word "unable" used in other similar *force majeure* provisions. Deyell J., after stating that *force majeure* provisions will be construed strictly, acknowledged that if the "unable" type of language were used, a claim for *force majeure* would be disallowed unless there was no alternative gas supply available. In

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16 *Ibid.* at 140.

17 *Ibid.* at 143.

the case at bar, the Court commented that Atcor was not "unable" to supply gas according to its firm supply commitment. Therefore, the Court indicated that it may have come to a different result if alternative wording were used in the *force majeure* provision.

Continental also argued if the NOVA curtailments amounted to *force majeure*, then Atcor failed to remedy the condition by either allocating its available supply to Continental or by purchasing replacement gas and transportation to deliver full volumes. However, the Court accepted Atcor's submission that subparagraph 9(b) did not apply, based on the fact that Atcor could not remedy such event of *force majeure*. In this regard, the Court recognized that as soon as NOVA resumed supply, Atcor resumed its supply to Continental. Also of importance is that the Court rejected Continental's argument that since Atcor was not "prevented" or "hindered" from performing its obligations, available supply should have been allocated. The Court stated the agreement did not contain "prevention" language. Further, the Court accepted Atcor's reliance on the House of Lords decision in *Bremer Handelsgeselischaft m.b.H.* v. *Vanden Avenne-Izegem P.V.B.A.*,[18] that a party falling within the language of a *force majeure* clause need not mitigate the consequences of the *force majeure* event, unless the particular clause explicitly so requires. Thus, the obligation of a seller to purchase make-up gas in the event of *force majeure* must be specifically provided for in the contract. In the present case, there was no requirement imposed by the *force majeure* provision to distribute supply on a pro rata basis, nor was there any evidence as to what would be proper and reasonable in the industry in such circumstances.

As a result, Atcor's obligations under the agreement were held as properly suspended by operation of the *force majeure* clause.

H. *LAKEWOOD 1986 DEVELOPMENT LTD. PARTNERSHIP* v. *FLETCHER CHALLENGE PETROLEUM INC.*[19]

The decision of Rawlins J. of the Alberta Court of Queen's Bench in this case is interesting since she limits the application of an indemnification provision in an agreement in light of the commercial context in which the agreement was entered into. The plaintiffs, which included Lakewood 1986 Development Ltd. Partnership and others, were the successors in interest to the farmee under a farmout and option agreement dated August 16, 1985. The defendants were successors in interest to the farmors under the agreement. The agreement acknowledged that the natural gas associated with the lands being farmed out were subject to existing gas sales contracts and the agreement contained an indemnity in respect of such contracts. The relevant portions of the agreement provide as follows:

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18 [1978] 2 Lloyd's L.R. 109 (H.L.).

19 (1994), 163 A.R. 115 (Q.B.).

23. Gas Purchase Contracts

...

(c) Farmor shall retain responsibility for and notwithstanding anything to the contrary contained herein, shall indemnify and save harmless the Farmee from and against all losses, costs, claims or damages which the Farmee suffers, sustains, pays or incurs as a result of:

(i) any of the Farmee's Natural Gas being taken in satisfaction of existing Take or Pay Delivery Obligations; or

(ii) Farmee being required to make any payment to satisfy Existing Take or Pay Delivery Obligations, or to satisfy the Lessor's royalty or any overriding royalty in respect of natural gas not paid for when produced whether such payment is out of production revenues or otherwise.

"Existing Take or Pay Delivery Obligations" was defined as meaning:

> the obligations of Dome and/or Provo arising under, or in respect of, any Gas Sales Contract to deliver natural gas produced from the Lands after the date hereof without receiving full payment therefor, as a result of payments made prior to such time....

Pursuant to the agreement, the defendants sold the plaintiffs' gas, the plaintiffs having taken no steps to sell gas on their own. Such gas was sold under the defendants' existing gas sales contracts. The plaintiffs never received any take-or-pay payments and were not signatories to the gas purchase contracts. Take-or-pay costs were deducted by the purchasers from the proceeds of the sales of gas by the farmors, which included the plaintiffs' share of production of gas.

The plaintiffs claimed the above clause indemnified them from having to pay take-or-pay carrying costs, which the defendants had deducted from the revenues paid to them. The defendants submitted the agreement did not provide an indemnity against take-or-pay costs in light of the commercial context in which the agreement was formed. The defendants alleged the clause only indemnified the plaintiffs for costs incurred as a result of payments to satisfy existing take-or-pay delivery obligations — an entirely different concept.

Although three main issues were tried, Rawlins J. disposed of the matter by ruling on the first issue. The ruling was that the take-or-pay costs were properly deducted by the defendants and the indemnification clause in the agreement did not apply.

In her decision Rawlins J. stated, "[i]n the absence of ambiguity, the contractual term is to be interpreted in accordance with its plain and ordinary meaning."[20] However,

[20] *Ibid.* at 119.

she then incorporated the reasoning outlined by Virtue J. in *Alpine Resources Ltd.* v. *Bowtex Resources Ltd.*[21]:

> It is however permissible, even where there is no ambiguity, to have regard to extrinsic evidence to discover the intention of the parties by interpreting words of the contract in the light of the circumstances in which they were used.
>
> ...
>
> Consideration of the commercial setting in which a contract is made, is not, of course, to be confused with parole [*sic*] evidence of the intention of the parties. That is not admissible.[22]

On the basis outlined in the *Alpine* case, Rawlins J. stated that it is open to the Court to consider "the commercial purpose, background, context, or what is sometimes called the commercial matrix in which the Farmout Agreement was made."

When reviewing the commercial context, the Court made a distinction between *take-or-pay costs* and *take-or-pay obligations*. In this regard Rawlins J. stated:

> Take or pay obligations were two sided, involving an obligation upon the buyer (i.e. TCPL) to pay for a certain quantity of gas even if it was not taken, and a corresponding obligation upon the producer to deliver that pre-paid gas at a subsequent time.
>
> By contrast, take-or-pay costs, were a carrying charge resulting from the financing of TCPL'S take-or-pay prepayments. They were more properly attributable to the stage of the buyer's initial acquisition of gas or prepayment (in cases where no acquisition was made), than to the stage of producer-delivery to satisfy an obligation.... In addition it is important to remember that take-or-pay costs were assessed under the regulations against every producer.[23]

The Court noted that the main concern for the farmee would be to avoid the assumption of take-or-pay delivery obligations but that, from a business perspective, it would have been unusual and not have made sense for the farmor to also pay for farmee's carrying costs, which costs were attached to every producer.

Therefore, even though the Court acknowledged that the language of the indemnity provision appeared to be broad enough to include take-or-pay costs, in light of the commercial context discussed, the Court found it clear that the inclusion of take-or-pay costs was not contemplated. Rawlins J. made this finding particularly in light of the definition of "Existing Take or Pay Delivery Obligations" and the fact that "take-or-pay costs" were not specifically referred to. Accordingly, the indemnity provision was limited to take-or-pay obligations only and was not applicable to take-or-pay costs.

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21 (1989), 66 Alta. L.R. (2d) 144 at 147, 96 A.R. 278 (Q.B.) [hereinafter *Alpine*].

22 *Supra* note 19 at 120. Rawlins J. quoted Virtue J. in *Alpine*.

23 *Ibid.* at 123.

The above case displays the importance of ensuring contingencies relating to a certain matter are covered in sufficient detail in indemnification provisions, and that the commercial context in which an agreement is entered into may become relevant when interpreting the agreement, even if the agreement is not ambiguous.

I. *WESTERN OIL CONSULTANTS LTD.* v. *BANKENO RESOURCES LTD.*[24]

The proceedings between the plaintiffs and the defendants involve two separate actions arising under the same royalty agreement. The decision is interesting because it shows the Court's interpretation of how damages should be calculated in respect of a breach of contract pertaining to a royalty agreement.

The plaintiff, Western Oil Consultants Ltd. ("Western Oil"), as grantee, and the defendants, Bankeno Resources Ltd. and others, as grantors, entered into a royalty agreement dated February 1, 1982, whereby the grantors granted and reserved a royalty interest in certain lands to Western Oil in respect of certain lands. Pursuant to the agreement, the defendants covenanted and agreed with the plaintiff that if the defendants "desired" to surrender, let to expire, abandon or release any interest in the lands covered by the agreement, the plaintiffs would be given notice thereof and the plaintiffs would have the option to either consent to the surrender, expiration, or abandonment or request an assignment of such rights and interest specified in the surrender notice.

In the first action, certain leases were scheduled to expire by their terms. Prior to expiry of the leases, the defendants drilled wells on some, but not all, of the lands covered by the leases. The defendants applied for continuation of all the lands under the leases, but the minister granted continuation for the drilled lands only. The plaintiffs received no notice of the continuation application or the impending expiry. The plaintiffs sued the defendants for breach of the agreement and breach of trust.

Applying the decision of the Alberta Court of Appeal in *Luscar*[25] (discussed in this article), McBain J. held that, on the facts, the parties merely intended to enter into a contract and that no trust relationship arose in the circumstances. The Court further held that the defendants' continuation application indicated their "desire" to continue the leases rather than to surrender their interests in the leases. Therefore, the defendants were not in breach of the notice or surrender provisions of the agreement.

In the second action, the defendants admitted that they let expire the interest in a lease covering certain lands and that they did not give written notice thereof to the plaintiff. The primary issue was the date at which damages would be assessed for the breach of contract.

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[24] [1995] A.J. No. 323 (Q.B.) (QL) and [1995] A.J. No. 331 (Q.B.) (QL).

[25] *Luscar Ltd.* v. *Pembina Resources Ltd.*, [1995] 2 W.W.R. 153, 162 A.R. 35 (C.A.) [cited to W.W.R.].

The plaintiff argued that the date of breach was the correct date for assessing damages. The defendants argued that damages should be assessed as of the date of trial or, if damages were assessed as of the date of breach, the Court should take into consideration subsequent events which would allow for a true assessment of the value of the interest in the lands.

McBain J. decided that

> damages will be assessed as of the date of breach with consideration of subsequent events which will allow for a true assessment of the value of the interest in the lands held by the Plaintiff.[26]

In the circumstances, the Court held that the fair market value of the lease was nominal given the uneconomic results of drilling on the lands and set the amount of damages in the amount of one thousand dollars.

Of particular importance is the plaintiff's argument that when the Court is assessing damages at the date of breach subsequent events can be taken into account even though the plaintiff did not seek specific performance or equitable damages in lieu of specific performance.

J. *NILSSON* v. *SASKATCHEWAN MUTUAL INSURANCE CO.*[27]

This decision displays the importance for either individuals or companies to ensure that their insurers be notified of any material change in risk in order to prevent termination of their coverage.

A contract of insurance was entered into between the plaintiff Nilsson and the defendant Saskatchewan Mutual Insurance Co. The plaintiff was the owner of a four-wheel-drive truck insured under a policy of automobile insurance with the defendant. A term of the contract was that the vehicle would be used "chiefly" for pleasure which was to include transportation between his residence and the place of business. Further, the plaintiff was to be the principal driver.

The plaintiff was hired by a drilling company, which hiring included the use of his truck in return for which the drilling company would pay the plaintiff for his time, gas and the promise to compensate him for any loss of the truck. Important to note is that prior to leaving for such work, the plaintiff attempted to advise the agent for the defendant of the arrangement he had entered into for the use of his vehicle. He was unable to do so. As a result, the defendant was not notified of the proposed change in use of the vehicle.

Another person employed by the drilling company used the plaintiff's truck and was involved in an accident in which the driver and the occupants of the other vehicle were injured. An agreed fact was that the defendant would not have insured the plaintiff's

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26 *Supra* note 24.

27 [1995] A.J. No. 296 (Q.B.) (QL).

truck for the use that occurred. When the defendant became aware of the use of the vehicle by a person other than the plaintiff, the defendant caused its solicitor to write to the plaintiff stating the defendant was voiding the contract from its commencement and the full premium was returned to the plaintiff.

Therefore, the issue was whether, on the facts, there was a material change in risk allowing the defendant to void the contract of insurance.

Picard J. of the Alberta Court of Queen's Bench held that there was a change in use of the insured vehicle when the plaintiff entered into the work arrangement and such change amounted to a material change in risk in the contract for insurance. The defendants were not informed of such change and would not have provided coverage had they known. Therefore, the plaintiff breached the contract and the defendant was accordingly entitled to void the contract for insurance.

K. *SCURRY-RAINBOW OIL LTD.* v. *GALLOWAY ESTATE*[28]

The following is a description of the Alberta Court of Appeal's decision pertaining to three test cases which were identified through a series of Queen's Bench orders that went to trial, all of which were addressed in the Court of Queen's Bench by Hunt J. in her judgment.[29]

The plaintiffs in the three separate actions were royalty certificate holders pursuant to gross royalty trust agreements ("GRTAs") entered into with three separate trust companies. Under the GRTAs, freehold mineral owners assigned their royalty or potential royalty interest as lessors under oil and gas leases to trust companies, which trust companies then sold units in the GRTAs.

In the first test case the owner leased the applicable lands *before* entering into the GRTA, and production commenced under the lease after the GRTA was executed. In the second case, the GRTA was executed during the term of the initial lease which then expired. Two subsequent leases were then executed by the owners or their successors and both of such leases expired without production. In the third case, the GRTA was executed during the term of an initial lease and then new leases were executed after the initial lease expired. Consequently, production commenced under the new leases.

In all three cases, the trial judge supported the continuing enforceability of the GRTAs and the caveats filed thereon. In each of the three cases, the successor entitled to the mineral interest appealed the trial judge's decision. The Court of Appeal dismissed the appeal and agreed with the decision of Hunt J. and her rationale with minor exceptions.

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28 [1995] 1 W.W.R. 316, 157 A.R. 65, 23 Alta. L.R. (3d) 193 (C.A.) [hereinafter *Scurry-Rainbow*, cited to W.W.R.]. Application for leave to appeal to S.C.C. dismissed with costs (without reasons) March 30, 1995.

29 *Scurry-Rainbow Oil Ltd.* v. *Galloway Estate*, [1993] 3 W.W.R. 454, 138 A.R. 321, 8 Alta. L.R. (3d) 255 (Q.B.).

The issues under appeal can be summarized as follows:

(1) whether the trustee's interest under the relevant GRTA constituted an interest in land so as to support a caveat;

(2) whether the subject GRTA applied to royalties under petroleum and natural gas leases which came into effect *after* the GRTA had been executed; and

(3) whether the rule against perpetuities was offended in the circumstances.

With respect to the first issue, the trial judge held that a lessor's royalty under a petroleum and natural gas lease can be an interest in land in the form of a "species of rent" or "akin" to a *profit à prendre.* The appellants, relying on *Berkheiser* v. *Berkheiser*,[30] argued that the lessor's royalty could not be *a profit à prendre* because that is exactly what the lessor grants to the lessee under a petroleum and natural gas lease. The Court of Appeal mentioned that the trial judge's response to such argument was that there was no theoretical reason why a freeholder cannot grant a right that is characterized as a profit while reserving to himself or herself another kind of right which could also be characterized as a profit.[31] Since the trial judge's decision did not rest solely on such findings, the Court of Appeal stated that it need not decide on that basis to answer the questions on appeal. The Court of Appeal went on to state:

> Nor would that constitute a reversible error, because she held that whether or not the reserved royalty in the subject P.&N.G. lease, in itself, amounted to an interest in land, a lessor's retention of the reversionary rights in the leased substances would be an interest in land capable of supporting a caveat.[32]

Thus, the Court of Appeal held as follows:

> It is our conclusion that following each of the so-called "initial" P.&N.G. leases, the lessor retained not only a reversionary right to the lessee's profit à prendre on the leased substances, but also a fee simple interest in those substances in situ, as constituted by the royalty reserved to the lessor in the lease. That interest is, of course, subject to the grant under the lease of a profit à prendre to the lessee (see *Berkheiser*, supra).[33]

The Court of Appeal went on to state that the "*in situ* approach" is well expressed in American authorities, which decisions are persuasive when not in conflict with authoritative Canadian decisions.

The appellant in one of the test cases argued that the decision of the Court of Appeal in *Guarantee Trust Co. of Canada* v. *Hetherington*,[34] should be followed since the

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30 [1957] S.C.R. 387.
31 *Supra* note 28 at 320.
32 *Ibid.*
33 *Ibid.*
34 67 Alta. L.R. (2d) 290, [1989] 3 W.W.R. 340.

form of GRTA was the same. However, in the present case, the Court of Appeal stated that the decision in *Hetherington* did not consider whether the GRTAs in issue, on the specific facts before it, conveyed an interest in land. Rather, the Court in *Hetherington* reached its decision on the perceived intention of the parties that the royalty assigned to the trustee was limited to the initial lease. In the present case, there was no reference to the initial lease. Since the terms of the subject GRTA contemplated application to royalties under subsequent petroleum and natural gas leases, and given the GRTA constituted an interest in land, the GRTA was held to apply to royalties under such subsequent leases.

On the third issue, at trial, Hunt J. determined that the rule against perpetuities was not offended. The trial judge's conclusion appears to be based on the fact that while the nature of the interest in GRTA may be postponed, because of the nature of oil and gas, there is no postponement of the actual vesting of the interest itself. The Court of Appeal found no reversible error in her reasoning and conclusions.

The Court of Appeal summarized its conclusions as follows:

> (1) The initial P.&N.G. lease, in each of the test cases, is correctly categorized as a grant of a *profit à prendre* to the lessee. The interest thus acquired by the lessee is less than a full fee simple interest — it is in fact a working interest granted to permit the lessee to mine, operate and produce the leased substances.
>
> (2) Following the grant of the lease, the grantor-lessor is left with two things, namely:
>
> (a) a fee simple interest in the subject minerals "in situ", but subject, of course, to the grant of the *profit à prendre*; and
>
> (b) the reversionary interest in the subject minerals with respect to the lessee's *profit à prendre*.
>
> These are clearly interests in land.
>
> (3) In accordance with the terms of the GRTA in each test case, the lessor-settlor granted to the trustee a royalty carved out of the mineral owner's said interest in land and this supported the caveat filed by it.
>
> (4) As pointed out by the trial judge, while the enjoyment of this interest may be postponed, because the nature of oil and gas, there is no postponement of the vesting of the interest itself.[35]

As a result of the foregoing, the Court of Appeal dismissed the appeals in respect of all three actions. We understand that leave to appeal to the Supreme Court of Canada was denied.

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[35] *Supra* note 28 at 323-24.

L. *BARRETT* v. *KREBS*[36]

This is yet another gross royalty trust agreement (GRTA) case. The interpretation placed upon one form of GRTA by the Court precluded the plaintiffs from continuing to receive royalty payments under circumstances in relation to which they say it was always intended that they would receive royalties. Part of their claim was to have the applicable GRTA rectified to reflect what they said was its true intention.

In 1950, one of the defendants, being the registered owner of mineral rights beneath certain lands, entered into a petroleum and natural gas lease. Under the terms of the lease, the lessor reserved a 12½ percent royalty. Such lease was caveated against title.

In September 1952, the defendant Betty Krebs transferred the mineral rights from herself to herself and her husband as joint tenants. In September 1953, the registered owners entered into a GRTA with Prudential Trust. The agreement was in the same form as that considered by the Alberta Court of Appeal in *Hetherington*[37] and more recently the "burden" GRTA which was considered in *Scurry-Rainbow*.[38] Prudential Trust caveated its interest.

Between 1954 and 1966 Prudential issued royalty certificates to various individuals pursuant to the GRTA. The plaintiffs or their predecessors were issued their certificates between January 1956 and February 1960.

In January 1959, the defendants granted a "top lease" (or option to lease) to Canadian Superior Oil of California Ltd. ("Canadian Superior"). In January 1960, the first lease expired without there having been any drilling on the leased lands. In February 1960, Canadian Superior exercised its option under the top lease. Note that royalty certificates were issued to the defendants' children and to the plaintiffs *after* the primary lease had already expired and *after* the new lease had come into effect as a result of Canadian Superior's exercise of its option under the top lease. In September 1991, Mason J. ordered that the royalties from the GRTA be paid into court. The plaintiffs stopped receiving royalty payments after the order. As a result, the plaintiffs sought a declaration that the GRTA applied to the production under the top lease then in force, as well as to production under any subsequent leases. Alternatively, they sought rectification of the GRTA to state that it applied to the top lease and to any subsequent leases.

Prior to dealing with the main issues, Hunt J. found it necessary to determine what portion of the evidence submitted at trial by the plaintiffs was admissible.

First, the plaintiffs argued that certain hearsay evidence be included. Such evidence was, in essence, a conversation which occurred in 1960 between one of the plaintiffs and the defendants. Hunt J. concluded such evidence was not admissible, considering

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36 [1995] 5 W.W.R. 23, 164 A.R. 218 (Q.B.) [cited to W.W.R.].

37 *Supra* note 34.

38 *Supra* note 28.

the "reliable and necessary" tests most recently set out by the Supreme Court of Canada in *R.* v. *Khan.*[39]

The plaintiffs also argued that evidence of certain events occurring after the date the GRTA was signed (*i.e.* September 1953) were admissible in order to allow them to make out their case based upon rectification, estoppel and fiduciary duty. The plaintiffs referred to such decisions as *Hart* v. *Boutilier*[40] and *Peter Pan Drive-In Ltd.* v. *Flambro Realty Ltd.*,[41] for the proposition that, "in a rectification case, subsequent conduct can be relevant."[42] Hunt J. agreed with the principle that evidence (including documents) of events after the date the GRTA was executed was all admissible (except for evidence excluded as hearsay).

The plaintiffs claimed rectification based upon:

(1) the intention of the parties to the GRTA; and

(2) the intention of the settlors.

With respect to the intention of the parties to the GRTA, Hunt J. concluded that the plaintiffs did not establish a case for rectification. Hunt J.'s interpretation of the authorities cited by each of the plaintiffs and the defendants led her to state that, "rectification concerns a correction of a written contract that does not accurately reflect the mutual intention of the parties at the time they entered into the written contract."[43]

On the basis that there was absolutely no evidence presented about the intention of the parties prior to the signing of the GRTA, Hunt J. was unable to conclude that, at the moment the written contract was entered into, Prudential and the defendants shared a common intention that the GRTA, would apply to subsequent leases. Hunt J. also commented that even though rectification is an equitable remedy, such remedy still requires the requisite proof and must operate within rules and guidelines and provide some predictability for future cases. Therefore, she did not grant rectification on the evidence presented.

The plaintiffs alternatively argued that the Court should rectify the GRTA on the ground that it did not accurately reflect the intention of the settlors (*i.e.* defendants). For similar reasons as outlined in the first rectification argument, there was no evidence at the time the settlors entered into the GRTA that would show the intent to extend the terms of the GRTA to subsequent leases. Nor was there any evidence that the settlors ever addressed their minds to this issue.

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39 [1990] 2 S.C.R. 531.

40 (1916), 56 D.L.R. 620 (S.C.C.).

41 (1978), 93 D.L.R. (3d) 221 (Ont. H.C.), aff'd 106 D.L.R. (3d) 576, leave to appeal to S.C.C. refused 32 N.S.R. 538.

42 *Supra* note 36 at 32.

43 *Ibid.* at 38.

The plaintiffs argued that the defendants should be estopped from denying that the GRTA applied to royalties from subsequent leases on the basis of estoppel by representation or estoppel by approbation.

With respect to estoppel by representation, Hunt J., after outlining the essential factors giving rise to such estoppel including the requirement for a legal relationship between the parties when the representation is made, concluded that because of the decision in *Hetherington*, the trust came to an end when the first lease expired in January 1960. Due to the exclusion of the hearsay evidence, Hunt J. could find no evidence that representations were made to the plaintiffs before that time. As a result, the plaintiffs' claim on this basis was denied.

With respect to estoppel by approbation, Hunt J. summarized the plaintiffs' arguments to say that the defendants took the benefit of royalties under the second lease from the date of production until 1989 and were, therefore, estopped from denying that the GRTA applied to royalties from subsequent leases. Hunt J. stated that she had the same difficulty in applying this principle of estoppel as she had with the other principle.

Hunt J. also commented that one of the defendants, who was the mineral rights title holder, could have been receiving royalties throughout in her capacity as a freeholder. Therefore, applying estoppel as against her would be difficult in the circumstances.

The plaintiffs next argued that the settlors under the GRTA, being two of the defendants, were title holders and owed fiduciary duties to the beneficiaries (*i.e.* those who become certificate owners). Hunt J. rephrased the plaintiffs' argument to say that the fiduciary duty was breached when the defendants entered into the top lease, thereby removing the motivation of the original lessee to drill under the first lease.

Hunt J. commented that the first question was whether a fiduciary obligation existed prior to determining whether a fiduciary duty has been breached. Hunt J. referred to the test set out by Wilson, J. in *Frame* v. *Smith*,[44] as restated by LaForest J. in *LAC Minerals Ltd.* v. *International Corona Resources Ltd.*[45] and stated that since there was no meaningful discretion which could be exercised by the settlors and since it could not be said that any of the certificate holders were "peculiarly vulnerable" to the settlors, no fiduciary duty was established. In light of the ruling on hearsay evidence, Hunt J. found no evidence that the plaintiff relied upon the settlors making the decision to purchase the certificate.

The plaintiffs also argued that, pursuant to clause 25 of the GRTA, by entering into the top lease the defendants effectively "cancelled" the first lease and were under an obligation to negotiate a reservation to the trustee of royalties under any subsequent leases. Though Hunt J. did not accept this argument, she admitted she did not know under what circumstances a lease could be said to be "cancelled" for the purposes of clause 25. She also stated that, when interpreting clause 25, the Court of Appeal in

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44 [1987] 2 S.C.R. 99.

45 (1989), 61 D.L.R. (4th) 14 at 27 (S.C.C.), 2 S.C.R. 534 [hereinafter *Lac Minerals*].

Hetherington did not address the circumstances under which a lease could be said to be "cancelled". Therefore, Hunt J. felt bound by the proposition that where the lease has expired due to non-production at the end of the primary term, Clause 25 is not engaged and the lessor has no obligation in those circumstances to obtain a reservation of royalty to the trustee under the new lease.

The plaintiffs raised two other minor matters which did not receive much analysis by Hunt J. and will not be repeated here. The plaintiffs' claim was dismissed.

III. LANDS, LEASES AND TITLES

A. *CHEVRON CANADA RESOURCES LTD.* v. *HILL ESTATE*[46]

On November 14, 1978, Fern Hill entered into a written petroleum and natural gas lease with Chevron Canada Resources Ltd. ("Chevron") for a mineral interest owned by her husband. She did this as agent and attorney for her husband pursuant to a power of attorney dated November 10, 1978. Mr. Hill died in 1979 and Mrs. Hill died in 1982. Their daughter, Gladys Demars, was the administratrix of Mr. Hill's estate. On December 8, 1982, the lawyer acting for Gladys sent a letter to Chevron's lawyers stating that the power of attorney and lease were void because Mr. Hill did not possess the mental capacity to execute the power of attorney.

On December 2, 1992, the Court of Appeal declared that both the power of attorney and the lease were void *ab initio* because of Mr. Hill's mental incapacity. It found that Mrs. Hill knew her husband was mentally incompetent when he executed the power of attorney; that Chevron had no knowledge of Mr. Hill's mental state; that the lease was a fair one; and that Gladys Demars accepted the benefits of the lease even though she was aware that her father was mentally incompetent at the time the lease and power of attorney were executed. In spite of these findings the Court held that, without a valid lease, Chevron was a trespasser in drilling for and extracting oil belonging to Mr. Hill and that Mr. Hill's estate was entitled to all of the revenue generated by the sale of its share of the mineral interest. In addition, the Court held that Chevron was not entitled to deduct its production costs and expenses as this would be the equivalent of allowing a remedy for unjust enrichment and there was no basis for such remedy.

The parties went before the Court of Queen's Bench for judgment on the monies payable by Chevron to the estate. The amount was calculated by taking the gross revenue from the oil produced that was attributable to the estate's interest ($1,012,746.67) and subtracting the amount of royalties that were paid to the estate ($151,911.99). The latter sum included taxes paid by Chevron. The total amount payable was $860,834.61. The assessment of damages did not appear to take into account the capital and operating expenses associated with obtaining production. This may be contrary to the damage assessment of the trial judge in *Prism* v. *Omega Hydrocarbons Ltd.*[47]

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[46] 94 Man. R. (2d) 229 (Q.B.).

[47] [1994] 6 W.W.R. 585, 149 A.R. 177, 18 Alta. L.R. (3d) 225 (Q.B.).

The Court looked at several changes of interest that occurred during the time of the lease. On June 30, 1982, Chevron assigned 50 percent of its interest to Newscope Resources ("Newscope"). The Court held that this contract was void as its foundation was the power of attorney, which was also void. All monies paid by Chevron to Newscope were therefore owed to the estate. There was no allowance for the fact that Chevron's sale to Newscope came before Chevron was aware of the fact that its lease with Mr. Hill was void. The same logic was applied to Chevron's sale of its remaining interest in the minerals to Great American Energy on September 30, 1991. The Court held that because Chevron's lease was void *ab initio*, Chevron had never held an interest in the minerals and therefore could not sell any interest to another party. Finally, the estate was entitled to all revenues generated by the sale of its share of the minerals from the land between September 30, 1991 and March 31, 1992 — a period during which Chevron had no interest in the minerals and acted only as unit operator, receiving and distributing the production revenue to interest holders. The estate also claimed an award of interest on the monies owing, but the Court, in its discretion, disallowed the claim due to the fact that the plaintiffs were not beyond reproach in the matter.

The 1992 Court of Appeal decision also prompted an action by Chevron against Mrs. Hill's estate and the beneficial owners of the mineral interest. Chevron alleged that Mrs. Hill made representations and warranties about her authority to execute the lease which induced Chevron to enter into the agreement. They claimed that because of this conduct the mineral interest was owned subject to the lease and the beneficiaries were constructive trustees for Chevron. The defendants filed a motion requesting that Chevron's statement be struck out for two reasons: because the issues raised had already been litigated in the earlier case of *Hill Estate* v. *Chevron Standard Ltd.*,[48] and because the causes of action were barred by either the *Limitation of Actions Act*[49] and or subsection 53(2) of the *Trustee Act*.[50]

The Court held that the issues raised in the earlier action were not the same as those raised by Chevron in the subsequent action. The issue in the earlier action was whether Chevron could enforce the lease against Mr. Hill's estate and the Court of Appeal held it could not. The issue in the subsequent action was different as it related to an action against Mrs. Hill's estate.

With regard to limitation of actions, the Court looked at the two *Acts* and found it was not clear which one applied to Chevron's action. Based on different interpretations the action could be statute barred or not. The Court held that the most appropriate way to deal with the issue was for the parties to proceed to trial where the applicable limitation period could be determined in accordance with the findings of the trial judge. As of yet the matter has not been dealt with at trial.

48 (1993), 83 Man. R. (2d) 58 (C.A.).

49 R.S.M. 1987, c. L150.

50 R.S.M. 1987, c. T160.

B. *LICKACZ* v. *MAGNA PETROLEUMS LTD.*[51]

This decision outlines some interesting points in respect of the doctrine of "equitable pooling", unjust enrichment and the overriding effect of the *Oil and Gas Conservation Act*[52] on freehold royalties.

Since the decision of the Alberta Court of Appeal simply upheld the Queen's Bench decision, a discussion of the latter decision is necessary.[53] The primary action was commenced by Lickacz, who represented the registered owners of the mines and minerals of the north-west quarter of a certain section of land (the "Section"). Lickacz sought an accounting for 12½ percent of the value of the gas produced from a well owned by the defendant oil companies. The defendants counterclaimed against the owners of the mines and minerals of the other three quarters of the Section in the event they were held to be obliged to pay the 12½ percent royalty to Lickacz, that three-quarters of that payment be recovered from the other three owners.

The owners of all quarter sections in the Section signed oil and natural gas leases in or about 1948, with three retaining a 12½ percent gross royalty and one retaining a 10 percent gross royalty. Eventually the defendants obtained the rights to drill and produce from all four leases on the Section. In the Court of Queen's Bench, Miller J. noted the *Conservation Act* contained regulations that only permitted one gas well to be drilled on each section. Therefore, the four quarter sections of the Section constituted a single gas spacing unit.

The defendants decided to drill a well on the Section hoping to tap into a Belly River gas pool drilled into by operators on the two adjacent gas spacing units. The well which was located in the plaintiff's quarter section hit the gas pool, but the defendants could find no buyer for the gas and therefore capped the well. When tests completed by the defendants showed that the gas pressure on the well in question was dropping because the two other wells on the adjoining sections were draining the pool, the defendants tried to negotiate a pooling arrangement with the operators of the other two wells. Eventually, the defendants entered into an agreement with the other operators by virtue of which the defendants were to receive 35 percent of the gas collected from all three wells on all three sections. Though the defendants expected they entered into a reasonable arrangement, they did not seek the agreement of the lessors to each quarter section in the Section as to how the royalty would be split. The defendants subsequently obtained agreement of all owners of each quarter section, except the plaintiff. The Lickacz group took the position that, because the well was on their land, they were entitled to a full 12½ percent of the 35 percent of production instead of 25 percent of 12½ percent.

Lickacz commenced an action for his 12½ percent of all production from the well. The defendants applied to the Energy Resources Conservation Board ("ERCB") for a

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51 162 A.R. 193, 83 W.A.C. 180 (C.A.).

52 *Supra* note 3.

53 (1993), 160 A.R. 193 (Q.B.).

forced pooling order under section 72 of the *Conservation Act* to cover the production from the Section and to deal with Lickacz's refusal to sign the amending agreement, which recognized the pooling agreement. The ERCB ruled that the defendants, being the owners of all four leases, did not need a forced pooling order and refused to issue one.

In dismissing the plaintiff's claim, Miller J. found the provisions of the *Conservation Act* enacted rules which clearly were intended to change the concept of the rule of capture.[54] The Court recognized that one of the main thrusts of these changes was to establish spacing units. The *Conservation Act* encouraged owners to enter into private agreements if possible but was prepared to force arrangements if owners could not agree. Since the *Conservation Act* specifically states that it overrides any pre-existing contract and applies to all wells in Alberta, Miller J. came to the conclusion that the legislature clearly intended the amendments to have a retroactive effect. Further, the regulations compelled sharing of proceeds of an owner's share of gas production on an acreage basis even though it was free for the owners to contract how compensation will calculated. The Court therefore concluded that the 1952 amendments to the *Conservation Act* superseded the rule of capture and only entitled Lickacz to receive 25 percent of 12½ percent of the total net production of gas produced and sold from the pooled unit by the defendants.

In the alternative, Miller J. expressed the opinion that even if he were wrong that the amendments to the *Conservation Act* did not amend the application of the rule of capture, the American view of equitable pooling should be recognized in the circumstances in order to resolve the problem of dividing production of gas in the Section.[55] Using this doctrine, Miller J. stated that Lickacz's share of production would be the same.

In the further alternative, Miller J. would apply the equitable doctrine of unjust enrichment.[56] This ruling was made on the basis that it was abundantly clear that some of the gas produced from the second well came from the other three quarter sections located in the Section. Further, Miller J. took notice that "the established practice in the oil industry in this province is to pool these types of production and divide it equitably among the mines and mineral owners in the spacing unit."[57] The Court therefore concluded, given that the other three mines and mineral owners had signed the amending agreements, to allow Lickacz to receive four times as much as such other owners would amount to an unjust enrichment in Lickacz's favour.

All three approaches end up with the same result. Therefore, the plaintiff's claim was dismissed at trial. The decision of Miller J. was appealed to the Alberta Court of Appeal. The Court of Appeal stated that they were in substantial agreement with Justice Miller's reasoning that the 1952 amendments to the *Conservation Act* retrospectively

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54 *Ibid.* at 200.

55 *Ibid.* at 201.

56 *Ibid.*

57 *Ibid.* at 202.

confined Lickacz to no more than 25 percent of the 12½ percent of the total net production of gas produced and sold by the defendants from the gas spacing unit.[58] The Court went on to say that each quarter must share equally in the production allocated to the Section and each owner is entitled to the royalty percentage earlier negotiated.

The Court of Appeal viewed with favour the trial judge's conclusions with respect to unjust enrichment.[59] Lickacz's claim that his royalties should be calculated on production from the whole section by the mere location of the well on his quarter was held to be unsupportable.

The Court of Appeal found it unnecessary to deal with the trial judge's conclusion about the availability of the doctrine of equitable pooling in Alberta. The Court of Appeal commented that there is much force to the argument that the equitable doctrine has been overtaken by Alberta's regulatory scheme as expressed in the legislation.[60]

Although the Court of Appeal seems to expect that equities will be dealt with pursuant to existing legislation (*i.e.* the *Conservation Act*), where such equities will not be dealt with by the Alberta Energy and Utilities Board (which replaced the ERCB), the doctrine of equitable pooling might still be utilized by royalty or working interest owners who do not expect that they have received their fair share of production from a common pool.

It is interesting that the judgment is silent with respect to the 35 percent share of production from the pool negotiated by the defendants with the two other operators. That amount appears to have been taken as equitable, but Lickacz had never agreed to it. Without such an agreement, normally accomplished through unitization, Lickacz arguably should have been entitled to 25 percent of 12½ percent of the actual production obtained from the Section.

C. *WHITE RESOURCE MANAGEMENT LTD.* v. *DURISH*[61]

The primary issue in this case is which of two competing parties, Durish or White Resource Management Ltd. ("WRM"), held the mineral rights in a parcel of oil producing land in Alberta.

Carlson owned a freehold parcel of land which included mineral rights. In 1969 he made two transactions. First, he granted a lease of mineral rights to Pawnee Petroleums Ltd. ("Pawnee"). Such mineral lease was caveated on title. Later in the same year, Carlson entered into an agreement for the sale of lands, including the mineral rights, to Vold. Vold registered a caveat evidencing such agreement. The registered owner, Carlson, died and the heirs granted a second lease of the mineral rights to Pawnee in

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58 *Supra* note 51 at 182.

59 *Ibid.* at 182.

60 *Ibid.*

61 [1995] 3 W.W.R. 609, 26 Alta. L.R. (3d) 153 (S.C.C.) [cited to W.W.R.].

1971, which was caveated in the same year. Therefore, this created a second competing claim in respect of the mineral rights. The second mineral lease to Pawnee went through various assignments, which lease was finally assigned to Haida Resources Ltd. ("Haida") in 1976, whose interest was caveated.

A third chain of interest was created in late 1976, when the heirs of Carlson granted lease options of the mineral rights to Normac Oils Ltd. ("Normac"), which options and leases were assigned to White in 1977. White registered caveats with respect of such leases in March 1977. In November 1977 White granted a one-year drilling option to Durish, which was not exercised. In December 1977 White, who claimed under the third chain of interests, gave notice to those claiming under the first and second chains of interests (Pawnee, Vold and Haida) to take proceedings on their caveats. Haida defended his caveat by filing a statement of claim and *lis pendens*. The other caveated claimants did not, with the result that the Pawnee and Vold caveats lapsed in February and March 1978.

In May 1978, Vold granted a lease to White who in turn caveated it in June 1978. Thus, White now had claims through two roots: the Normac root and the Vold root.

In October 1978, Durish entered into a farmout agreement with White, acquiring an option on 50 percent of White's interest in the minerals whatever its source. Durish caveated the farmout agreement in February 1981. While White had consolidated the Normac and Vold claims of interest in the mineral rights, his right to them was clouded by the outstanding Haida claim to the same mineral rights, as well as by any reversionary rights which Vold might hold. Durish became aware of these problems prior to his company drilling a well on the lands. To protect his investment, Durish acquired any reversionary interest that Vold had in April 1979, and took assignment of Haida's interest in the 1971 Pawnee lease in May 1979. Durish caveated these interest in June and July 1979, respectively. As a result of the agreement with Durish, Haida discharged its *lis pendens*. A successful exploratory well was drilled in May 1979. WRM is the successor to White.

White sued, seeking a declaration of the lease from Vold in 1978 under which White claimed he had priority over Durish's subsequently acquired interests. Durish counterclaimed that the lease interest acquired in 1979 from Haida to consolidate his position had priority. A non-suit motion brought by the White interest was allowed.[62] The Alberta Court of Appeal dismissed an appeal from this motion.[63] Durish appealed to the Supreme Court of Canada.

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62 *White Resource Management Ltd.* v. *Durish* (1990),77 Alta. L.R. (2d) 131 (C.A.). For a review of this case, see E.A. Leew & M.A. Thackray, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (1992) 30 Alta. L. Rev. 308.

63 *White Resources Management Ltd.* v. *Durish* (1992), 5 Alta. L.R. (3d) 372, [1993] 1 W.W.R. 752 (C.A.).

McLachlin J. divided the issues into those concerning the *Land Titles Act*[64] and other issues.

1. *Land Titles Act* Issues

Durish's claim rested on the Haida lease and claimed priority on the ground that, on the register, the Haida caveat was prior to the caveat through which White claimed. Durish argued that under the *Land Titles Act*, the register is determinative of priority and that his claim should prevail. White raised three arguments against Durish's claim under the *Land Titles Act* and the Court dealt with each.

a. The Effect of s. 195 of the *Land Titles Act*

Durish relied on s. 195 of the *Land Titles Act*, which granted him protection against any interests which were not registered at the time he acquired the Haida lease. The arguments centred around s. 195 as it stood in 1979. The relevant portions of the section read as follows:

> 195 Except in the case of fraud, no person contracting or dealing with or taking or proposing to take a transfer, mortgage, encumbrance or lease *from the owner of any land in whose name a certificate of title has been granted* shall be bound or concerned to inquire into or ascertain the circumstances in or the consideration for which the owner or any previous owner of the land is or was registered..., nor is he affected by notice direct, implied or constructive, of any trust or unregistered interest in the land, any rule of law or equity to the contrary notwithstanding.... [emphasis added].

White argued that s. 195 did not assist Durish because Durish was not dealing with the "owner," defined in s. 1 of the *Act* as a person entitled to any interest in land. Mason J. accepted this argument at trial. The Court of Appeal, dismissing the appeal on other grounds, doubted the conclusion of Mason J. by commenting that a broader application of s. 195 is more in keeping with the principles of the Torrens system and the settled practice of Alberta.

McLachlin J. of the Supreme Court of Canada agreed with the Court of Appeal and stated,

> I agree with the Court of Appeal that the strict application of the section to only those dealing with the registered owner in fee simple is not in keeping with the principles of the Torrens system. One of the most important features of the Torrens system is the reliability of the Register. By obviating the necessity to look behind the title, the Register allows those who deal with land to do so more efficiently...
>
> The broader interpretation favoured by the Court of Appeal is supported by the fact that in consequence of this litigation and recommendations by the Alberta Law Reform Institute, Report No. 63, the Alberta Legislature has amended s. 195 so as to include those dealing expressly with "owners"

[64] R.S.A. 1980, c. L-5.

> of other interests under the scope of the protection provided by the provision. The amendment was enacted so as to be retroactive to the date of the first Alberta *Land Titles Act*, S.A. 1906, c.24. As I read this amendment, it is intended to be clarification of the scope of the section rather than an expansion of the section to cover new classes of parties. It follows that the original s. 195 should be interpreted in conformity with the amended section, and that Durish can rely on the protections of Section 195.[65]

b. The Effect of the Intervening White Caveat

White also argued that even though the Haida caveat was prior to White's caveat, the Haida caveat did not confer priority on Durish because Durish took subject to White's caveat, which had been registered in the interim. This was the basis upon which the Court of Appeal upheld the decision of Mason J.

McLachlin J. rejected this argument for two reasons:

(1) On the basis of the principle that an assignee of a caveated interest can claim priority through the original caveat (applying *Calford Properties Ltd.* v. *Zeller's (Western) Ltd.*[66]). Therefore when Durish took an assignment of Haida's interest in the Pawnee lease in 1979, Durish took all the interest Haida had in that lease, including Haida's position of priority, undiminished by White's intervening interest. The Court commented that to do otherwise would undercut the free and convenient alienability of land, one of the principles of the Torrens system.

(2) The Court recognized the amendment in 1982 to the *Land Titles Act* to reflect the principle set forth in the above paragraph. Since 1982, s. 135.1 of the *Land Titles Act* specifically allows for assignment of the caveat itself. Therefore, Durish was able to claim priority through the Haida caveat not only because the underlying lease which was protected was assigned to him, but also because he had taken an assignment of the Haida caveat itself.[67]

c. The Effect of Lapse of a Caveat upon Priority

White also argued that the Vold interest had priority over the Haida lease, notwithstanding the lapse of the Vold caveat in 1978. McLachlin J. considered that this was an issue of priority as between the Vold interest and the Haida interest, and pointed out the argument was not concerned with the lapse of the underlying interest, which clearly survived.

In this regard McLachlin J. stated:

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65 *Supra* note 61 at 617.

66 [1972] 5 W.W.R. 714 at 722-23 (Alta. C.A.).

67 *Supra* note 61 at 617-18.

> In my view, the argument that the priority of the Vold interest did not lapse with the caveat protecting it must fail. In *Boulter-Waugh & Co.* v. *Phillips*,[68] this Court held on facts similar to those in the case at bar that the lapse of the caveat resulted in a corresponding loss of priority in the underlying interest.[69]

McLachlin J. disagreed with the interpretation of Kerans J.A. of the Court of Appeal as characterizing the decision in *Boulter-Waugh* as involving abuse of process.

Further, McLachlin J. specifically stated that the cases of *Bensette and Campbell* v. *Reece*[70] and *Passburg Petroleums Ltd.* v. *Landstrom Developments Ltd.*[71] were concerned with the different issue of whether a lapse of a caveat destroys the underlying interest (*i.e.* not whether lease of a caveat results in the loss of priority of the underlying interest). McLachlin J. also stated:

> Section 135 gives priority to caveators "so long as a caveat remains in force", against another registered interest; this is the rule in *Boulter-Waugh.* This does not derogate from the rule, however, that an interest underlying a caveat is still enforceable against an owner; this is the rule in *Bensette* and *Passburg.*[72]

As a result of the foregoing, the Supreme Court of Canada held that the lease protected by the Haida caveat gained priority over the Vold interest, as against Carlson, when the Vold caveat lapsed in March 1978.

2. Other Issues

Both parties made submissions on other matters, including whether the lease underlying the Haida/Durish caveats were valid. However, the Court did not make a determination on such other issues since the evidentiary record was insufficient and it was held that it would not be appropriate for the Court to rule on it at this time.

The Supreme Court of Canada allowed Durish's appeal, quashed the order of non-suit and remitted the matter to trial for determination of the outstanding issues.

IV. FIDUCIARY DUTIES

A. *LUSCAR LTD.* v. *PEMBINA RESOURCES LTD.*[73]

The decision of the Alberta Court of Appeal in this case clarifies many of the issues pertaining to fiduciary duties applicable to parties under area of mutual interest, joint operating or other similar agreements.

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68 (1919), 58 S.C.R. 385, (*sub nom. Union Bank of Canada* v. *Boulter Waugh Ltd.*), [1919] 1 W.W.R. 1046.

69 *Supra* note 61 at 619.

70 [1973] 2 W.W.R. 497 (Sask. C.A.).

71 (1984), 8 D.L.R. (4th) 363, [1984] 4 W.W.R. 14, 30 Alta. L.R. (2d) 379 (C.A.).

72 *Supra* note 61 at 621.

73 *Supra* note 25. Application for leave to appeal to S.C.C. submitted February 28, 1995.

Pembina Resources Limited ("Pembina") purchased certain oil and gas properties in 1971 and 1972 and participated in a pooling agreement relating to parts of those properties in 1976. Pembina failed to provide written notice to Norcen Energy Resources Limited ("Norcen") and Luscar Ltd. ("Luscar") as required pursuant to an area of mutual interest ("AMI") clause contained in an operating agreement. Luscar and Norcen did not commence the initial action until 1986. The trial judge found that failure to give notice constituted a breach of contract, a breach of fiduciary duty, a breach of trust and resulted in unjust enrichment and that the causes of action were not discovered or discoverable by Norcen and Luscar until 1983. Further, the trial judge held that contract action was barred by the *Limitation of Actions Act*,[74] but he imposed liability on the equitable grounds.

Pembina appealed the decision of the trial judge, and Norcen and Luscar cross-appealed. The main issue on appeal was whether Pembina's failure to provide written notice pursuant to the AMI clause in the agreement gave rise to concurrent liability in equity and contract, thereby extending the time for commencement of an action.

The AMI clause contained in the agreement expressly provided that where any party acquired or desired to acquire interests within a specified area set out in the AMI clause, written notice of such acquisition would have to be provided to the other parties, including advice as to the details of the price or other consideration paid for such acquisition. Each of the other parties would then have a preferential right to purchase a proportionate share in the property acquired within the AMI.

Also important are various statements made by Conrad J. of the Alberta Court of Appeal in her outline of the facts pertaining to this case. For instance, when Pembina pooled its interests in order to create a spacing unit for the drilling of a gas well on certain lands, Conrad J. disagreed with the trial judge's interpretation that the pooling agreement triggered obligations under the AMI clause. More specifically, Conrad J. stated:

> In my view, on any reasonable interpretation of the intent of the parties, that transaction was not an "acquisition" of the type referred to in cl. 18, notwithstanding it resulted in ownership of different lands. The right to those new lands is really an extension of the pre-existing acquisition. It is important to consider the nature of a pooling agreement. While it results in an interest in new lands, the right to such a new interest is derived solely from the ownership of existing lands. It is not in any way an acquisition in the open market place.[75]

In this regard, it is important to note that the Court of Appeal was not specific on whether the pooling agreement referred to effected a cross-conveyance of working interests in the natural gas rights or was merely a pooling for the purposes of production.

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[74] R.S.A. 1980, c. L-15 [hereinafter the *Limitations Act*].

[75] *Supra* note 25 at 165.

In any event, Conrad J. stated that Norcen's and Luscar's rights would flow from the acquisition of Crown lands, but not pooled lands. In her view, the AMI clause was limited to original acquisitions and not to rights which arose subsequent to that original acquisition.

The Court acknowledged that,

> [t]he past dealings of the parties with regard to other acquisitions show a course of conduct which did not always include written notice and indicate an awareness by the parties of the AMI provisions.[76]

When reviewing the trial judgment, Conrad J. noted the following:

(1) The failure to give notice was not a result of any dishonesty or fraud on the part of Pembina. However, the Court recognized that the issue of fraudulent concealment, as such term is used in the *Limitations Act*, was not raised as an issue.

(2) Neither Luscar nor Pembina waived its right to be informed of any acquisitions.

(3) The fact that Norcen and Luscar initially cross-appealed the decision that the action was barred by para. 4(1)(c) of the *Limitations Act* on the basis that the discoverability rule should apply to actions on contracts (contrary to the decision of the Alberta Court of Appeal in *Fidelity Trust Co.* v. *98956 Investments Ltd.*[77]). Such application to reconsider *Fidelity Trust Co.* was dismissed at an earlier date by a panel of the Court and the Court did not hear argument on that issue.

On the basis of the above facts, the Court of Appeal considered the following issues:

(1) Can there be concurrent causes of action available in both equity and contract?

(2) Did the trial judge err in finding a breach of fiduciary duty?

(3) Did the contract create an express or implied trust?

(4) Was unjust enrichment available on the facts?

(5) Did the trial judge err in determining there was no discovery and no discoverability?

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76 *Ibid.* at 166-67.

77 (1988), 61 Alta. L.R. (2d) 193, [1988] 6 W.W.R. 427, 89 A.R. 151, 47 C.C.L.T. 80 (C.A.) [hereinafter *Fidelity Trust Co.*].

(6) Did the trial judge err in failing to assess damages in the circumstances of the case by applying breach of contract principles which limit damages to those in the contemplation of the parties at the time of the breach?[78]

1. Issue 1

Conrad J., following the recent decision of the Supreme Court of Canada in *BG Checo International Ltd.* v. *British Columbia Hydro & Power Authority*,[79] stated that,

> the mere fact that the parties have dealt with a matter expressly in a contract does not necessarily mean they intended to exclude the right to sue in equity, if such an independent right exists. The parties should not be prohibited from seeking the appropriate remedy for the wrong that occurred.[80]

As a result, the Court recognized that concurrent liability in contract and tort can exist, but the determination as to whether an independent equitable cause of action exists depends on the facts of each case. Conrad J. stressed that each contract must be examined in its entirety to determine whether the parties intended to negate or reduce, any equitable obligation by the terms of the contract.

2. Issue 2

Prior to its determination of whether the trial judge erred in finding a breach of a fiduciary duty by Pembina, the Court of Appeal reviewed the decisions of the Supreme Court of Canada in *Frame* v. *Smith*[81] and *LAC Minerals*,[82] both of which enunciate a three-step analysis associated with such determination. Such analysis is outlined by Wilson J. in the *Frame* v. *Smith*[83] decision as follows:

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

In a commercial relationship, the most difficult factor to prove is the vulnerability or dependency of the beneficiary. Conrad J. quoted the definition of vulnerability

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78 *Supra* note 25 at 159.
79 *Supra* note 14.
80 *Supra* note 25 at 173.
81 *Supra* note 44.
82 *Supra* note 45.
83 *Supra* note 44 at 136.

outlined by Wilson J. in *Frame* v. *Smith*, as having the necessary element of the "grave inadequacy or absence of other legal or practical remedies to redress the wrongful exercise of the discretion or power."[84]

The trial judge found Pembina breached its fiduciary duty in three ways:

(1) Pembina, as *Manager-Operator*, stood in a fiduciary role and breached its obligations as Manager-Operator by failing to provide geological interpretations to the other parties;

(2) the AMI clause itself created a fiduciary relationship among all the parties who acquired property and the remaining parties; and

(3) there was a breach of an express or implied trust which would impose fiduciary obligations.

Subsection 6(1) of the agreement afforded Pembina, as Manager-Operator, the sole and exclusive control of the exploration and operation of the lands covered by the agreement. Conrad J. agreed with the trial judge that such provision provided the scope for an operator to abuse or misuse its position of control for its personal gain. Conrad J. stated:

> While I accept that there may be fiduciary aspects of the duties of an operator, not every duty is fiduciary. There mere fact the contract imposes responsibilities on one party upon which another relies, does not mean the first party is automatically a fiduciary with respect to the duty created. Moreover, where a specific term of a contract addresses an issue, the contractual remedy may properly redress the wrong, thereby reducing any vulnerability. The parties, having addressed the issue specifically by contract, without making the duty to give notice a fiduciary one is also a factor to be considered.[85]

When assessing Pembina's liability as *operator*, the Court of Appeal mentioned that the trial judge found no fraud and that there was no evidence that Pembina knowingly or recklessly concealed the cause of action prior to 1983. Therefore, the Court decided that the issue became one of whether Pembina, as operator, had any obligation to the other parties to provide written notice, information, or any opportunity to participate in the purchase of adjacent property. Conrad J. was of the opinion that there was no such obligation and that there was nothing in the agreement to prevent the operator from purchasing adjacent property without providing notice, information and the right to participate to the non-operators.

The Court acknowledged that each party had the contractual right to extensive information and rights of inspection and, as a result, there was nothing in the relationship or the contract to suggest dependence on Pembina in that regard. The trial judge was found to have erred in finding that Pembina had breached any fiduciary duty in its performance as operator and in finding that Pembina, as operator, had an

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[84] *Supra* note 25 at 174. Conrad J. quoted from *Frame* v. *Smith*, *supra* note 44 at 137.

[85] *Ibid.* at 176-77.

obligation to supply its internal analysis or geological interpretations to the other parties, even though information compiled from operation of the joint lands was used in preparing such interpretations. In this regard, the Court accepted the evidence showing that the sharing of geological information was neither standard practice nor expected.

Also important is the finding of the trial judge that the play developed by Pembina in the AMI lands was developed only by reason of Pembina's position of Manager-Operator. This finding was not supported by the evidence, according to Conrad J. In a more general sense, the Court held that, apart from the AMI clause, Pembina had no obligations with respect to information or notice and Pembina did not breach a fiduciary duty as *Manager-Operator.*

Next, the Court went on to determine whether any of the parties, upon acquiring adjacent properties, would have, outside of the obligations set out in the AMI clause, an obligation to provide notice, information and an opportunity to participate to the others (*i.e.* whether the relationship was one of vulnerability). When reviewing this question, the Court acknowledged that the contract specifically provided that the relationship between the parties was not a partnership, that all three parties were sophisticated business entities and that had the parties intended the clause to create fiduciary obligations, they could have so provided. Having regard to such factors, the Court of Appeal recognized that, without more, there was nothing in the relationship between the parties that would have prevented any of them from purchasing properties outside the joint lands without providing notice, information or the right to participate.

Having overcome this hurdle, the Court went on to decide whether the AMI clause created a fiduciary obligation. In this regard, Conrad J. stated,

> The fact that the contract did not suggest the duties were fiduciary, however, is indicative of an intent to reduce all obligations to contractual ones. Moreover, the contract contained both no partnership and entire agreement provisions, which confirm this intent. What was created was a contractual, not a fiduciary term.[86]

The Court indicated that whether a fiduciary duty may be owed by one party to another depends on the nature of the relationship (*e.g.* partnership or joint venture). In the present case, the Court of Appeal held that none of the parties were partners or joint venturers.

Further, the Court was of the opinion that the reliance on another party for notice under an AMI or other similar provision is not vulnerability derived from a relationship, but a right derived from a contract. Conrad J. also stated:

> *[T]he real complaint is the failure to give notice. The argument that an AMI results in fiduciary duties relies entirely on the issue of notice. In my view, the fact notice is required, and relied upon, does not make it a fiduciary obligation.* The only duty to give notice is because of the contract ... Had the

86 *Ibid.* at 184-85.

parties wished, they could have specifically provided that a failure to give notice extended the time or created a fiduciary duty. They did not do so.[87]

Conrad J. stated:

There is always vulnerability where a contract calls for notice, but a notice provision, without more, does not create a fiduciary duty. Had there been a fraudulent concealment of the transaction, the time limited for commencing in action in contract would have been extended by s. 6 of the *Limitations Act*.[88]

Therefore, the Court concluded that the requirement of notice was not sufficient to give rise to a fiduciary duty to give notice. Further, the Court acknowledged that such notice, if it were fiduciary in nature, would not have to have been given in writing and that the onus would have rested on Norcen and Luscar to prove that no notice of any kind was given.

3. Issue 3

The trial judge found that the AMI clause created an express or implied trust. The Court of Appeal disagreed with this finding and was of the view that there was no certainty of intention in clause 18 in order to create a trust. Further, since trust language was used in other provisions throughout the agreement, and in light of the "entire agreement" provision which stated that there were to be no implied covenants, the Court held that a trust should not be implied where it was not specifically expressed. Further, since applicable limitation periods are an important consideration for any party entering into an agreement, and given the natural inference of parties to a contract to intend that the applicable limitation periods for breach of the agreement will be that applicable to breach of contract, clear language will be required in order for a longer limitation period to be applicable.

In any event, the Court held that there was no express or implied trust since "the case at bar involves a contingent right to participate and is distinguishable from all the authorities dealing with an agreement for sale, because until such time as there is notice and an exercise of the right to purchase, there is no certainty as to the beneficial interest."[89]

4. Issue 4

Prior to determining whether a remedy for unjust enrichment was available, Conrad J. discussed the foundation of the principle. She stated that unjust enrichment is recognized as an action independent of contract and tort. She specifically incorporated[90] the test for unjust enrichment as outlined in *Rathwell* v. *Rathwell*,[91]

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87 *Ibid.* at 188.
88 *Ibid.* at 189.
89 *Ibid.* at 195.
90 *Ibid.* at 196.

in which Dickson J. stated: "[t]he facts must display an enrichment, a corresponding deprivation, and the absence of any juristic reason — such as a contract or disposition of law — for the enrichment." The trial judge found that all three components were met in this case.

In this regard, Conrad J. stated that though the failure to give notice may have deprived Luscar and Norcen of an opportunity, this was not the same as the case of a secret profit by a fiduciary. Again, the Court emphasized that the rights of such parties were contractual and that remedies were available if discovered and acted upon within proper limitation periods. In any event, Conrad J. concluded that Luscar and Norcen had notice of the facts necessary to establish their cause of action. Specifically, the Court acknowledged that:

> If the other party does not sue within the time set out in the *Limitations Act*, then, without more, there *is* a juristic reason for the gain because the breaching party is entitled to rely on the intended limitation.[92]

Again, Conrad J. made reference to the "complete agreement" and "no implied term" clauses as being indicative of the parties desire to limit their obligations to those in contract. Perhaps the rationale of Conrad J. is that the evidence at trial indicated no unconscionable actions on the part of Pembina and, even though the finding was that there was no written notice given, there was at least some evidence indicating that the parties had in the past dealt orally with respect to AMI obligations and documented them later. Therefore, the Court chose not to impose the doctrine of unjust enrichment in the circumstances.

5. Issue 5

The Court of Appeal, when determining whether the trial judge erred in holding there was no discovery and no discoverability of Pembina's failure to give written notice, reviewed the discoverability rule as stated by Le Dain J. in *Central & Eastern Trust Co.* v. *Rafuse*,[93] and stated:

> I am thus of the view that the judgment of the majority in *Kamloops [Kamloops (City)* v. *Nielsen*, [1984] 2 S.C.R. 2] laid down a general rule that a cause of action arises for the purposes of a limitation period when the material facts on which it is based have been discovered or ought to have been discovered by the plaintiff by the exercise of reasonable diligence....[94]

The Alberta Court of Appeal held in *Fidelity Trust Co.*[95] that the discoverability rule did not apply to contract. In the event that case was wrongly decided, the Court decided

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91 [1978] 2 S.C.R. 436 at 455, 2 W.W.R. 101.
92 *Supra* note 25 at 197.
93 [1986] 2 S.C.R. 147 [hereinafter *Rafuse*].
94 *Supra* note 25 at 200. The Court of Appeal quoted Dickson J. in *Rafuse*, *ibid.* at 224.
95 *Supra* note 77.

to review what must be discovered. In this regard, Conrad J. stated that discovery applies to the facts, not the law.

The position of Luscar and Norcen was that mere knowledge of the acquisition by Pembina alone was not sufficient. Rather, they were of the opinion that there must be discovery of the fact that the acquisition fell within the AMI clause of the agreement. However, in response to this argument, Conrad J. stated:

> In my view, it is the responsibility of a party to monitor its own contract, and put into force such mechanisms as may be required to aid it in identification of breaches, if it feels such mechanisms are necessary. If not, then it is the risk of the party whose mechanisms are not sufficient. In the case at bar, Luscar and Norcen ask for the limitation period to be extended, because they did not realize the land purchased by Pembina was within the AMI even though they knew of the purchase and knew the contract. This is untenable.[96]

As a result of the foregoing, the Court held that the information in respect of the acquisitions was readily discoverable and that the onus of disproving knowledge of such acquisitions rests on the plaintiff when the defendant raises a limitation period. The Court stated the evidence was overwhelming that Norcen had actual knowledge of the acquisition of the Crown lands by Pembina and, in the case of Luscar, there was evidence that Luscar was aware of the AMI within nine days of the sale and monitored information for activity on lands adjacent to those managed. As a result, the Court held that both companies had access to all the facts required to determine or discover that they had a cause of action.

To summarize, the Court held that the only viable cause of action was for breach of contract and that such cause of action was statute-barred on the basis of the *Fidelity Trust Co.* decision and, in respect of the Crown and pooled lands, would be statute-barred in any event because the facts required to establish the cause of action were discovered. Therefore, the appeal was allowed, the trial judgment vacated and the claim dismissed.

B. *HODGKINSON* v. *SIMMS*[97]

Though not a case dealing specifically with oil and gas matters, this case contains some interesting comments in respect of fiduciary duties and the damages which may be available for breach of such duties. Therefore, the facts of the case will not be discussed, though it is interesting to note that there were no allegations of fraud or deceit against the respondent.

In the decision, LaForest J. commented that the existence of a contract does not necessarily preclude the existence of fiduciary obligations between the parties and the "legal incidents of many contractual agreements are such as to give rise to a fiduciary

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96 *Supra* note 25 at 204.

97 (1994), 117 D.L.R. (4th) 161 (S.C.C.).

duty."[98] At first glance, this appears to contradict the decision in *Luscar*. However, the two cases might be distinguishable both on the nature of the relationship and the fact that there was no written agreement in the present case.

Further, LaForest J. stated the existence of a fiduciary duty depends on reasonable expectations of the parties, including factors such as trust, confidence, complexity of subject matter, and community or industry standards. Also important to note are these comments of LaForest J.:

> In seeking to identify various civil duties that flow from a particular power-dependency relationship, it is simply wrong to focus only on the degree to which a power or discretion to harm another is somehow "unilateral"... *Ipso facto*, persons in a "power-dependency relationship" are vulnerable to harm. Further, the relative "degree of vulnerability", if it can be put that way, does not depend on some hypothetical ability to protect one's self from harm, but rather on the nature of the parties' reasonable expectations. Obviously, a party who expects the other party to a relationship to act in the former's best interests is more vulnerable to an abuse of power than a party who should be expected to know that he or she should take protective measures.[99]

LaForest J. concentrated on the principle that each specific relationship must be analyzed to determine the legal and/or equitable obligations which may arise.

Another item of particular importance is LaForest J.'s distinction between the facts in this case from that which arose in *LAC Minerals*. LaForest J. refers to the present case as being one within the "professional advisor context", where the very basis of the contract is that the advisor will use his or her special skills on behalf of the advisee. In particular, LaForest J. noted:

> In sharp contrast to arm's length commercial relationships, which are characterized by self-interest, the essence of professional advisory relationships is precisely trust, confidence, and independence.[100]

The respondent also argued that it would be grossly unjust to hold him accountable for losses that had no causal relation to the breach of fiduciary duty. The majority of the Supreme Court of Canada stated that the appellant would not have been subject to any of the risks associated with the investments had it not been for the breach. Therefore, the Court considered it right and just that the breaching party account for the full loss. However, LaForest J. added that a breach of fiduciary duty can take a variety of forms and therefore there may also be a variety of remedial considerations. The Court therefore indicated that assessment of damages may vary depending on the circumstances of each case.

As a result, LaForest J. held that it would be unjust to place the risk of market fluctuations on the appellant who would not have entered into the transaction but for the defendant's wrongful conduct. Therefore, LaForest J. agreed with the trial judge's

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98 *Ibid.* at 174.

99 *Ibid.* at 179.

100 *Ibid.* at 181.

assessment of damages. The Court went on to state that the damages under breach of contract would be the same as that for breach of fiduciary duty. The majority for the Supreme Court of Canada therefore allowed the appeal and restored the order of the trial judge, with costs throughout.

V. TAX

A. *PAN OCEAN OIL LTD.* v. *CANADA*[101]

The trial decision for this case appeared in last year's "Recent Judicial Developments"[102] article and the following is the appeal by the Crown from that judgment.

The case concerned the *Income Tax Act*[103] and its effect on the amalgamation of two Alberta corporations. Pan Ocean Alberta Ltd. ("Pan Alberta") and Pan Ocean Oil Ltd. ("POOL") amalgamated to form Pan Ocean Oil Ltd. ("the respondent"). POOL originated from a series of mergers which resulted in it being the holder of a number of oil and gas assets which had previously been owned by a group known as the Dynamic Companies. Those companies had incurred deductible exploration and drilling expenses which the respondent attempted to deduct in its 1974 and 1975 taxation years. Subsection 83(A)(8d) of the pre-72 *ITA* and subsection 29(29) of the *Income Tax Application Rules*,[104] allowed "second successor corporations" to make such deductions and at trial it was held that the expenses were deductible by the respondent.

The parties had agreed that POOL was a "second successor corporation" and that the amalgamation of POOL and Pan Alberta in 1974 came under s. 87 of the *ITA*, which read as follows:

> 87. ...
>
> (2) Where there has been an amalgamation of two or more corporations after 1971 the following rules apply:
>
> (a) for the purposes of this Act, the corporate entity formed as a result of the amalgamation shall be deemed to be a new corporation the first taxation year of which shall be deemed to have commenced at the time of the amalgamation, and a taxation year of a predecessor corporation that would otherwise have ended after the amalgamation shall be deemed to have ended immediately before the amalgamation;

101 170 N.R. 323 (F.C.A.). Application for leave to appeal to S.C.C. dismissed with costs (without reasons) November 17, 1994.

102 W.H. Bonney & J.J. Park, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (1995) 33 Alta. L. Rev. 365.

103 S.C. 1970-71-72, c. 63 [hereinafter *ITA*].

104 S.C. 1970-71-72, c. 63, Part III.

The trial judge was of the view that, under corporate law, the respondent was considered a continuation of POOL rather than a third successor. At the relevant time, third or subsequent successor corporations were not allowed to deduct expenses such as those at issue here. The Federal Court of Appeal ("FCA") noted that although under corporate law an amalgamation does not put an end to the amalgamating companies, for tax purposes the result may be different and the issue must be examined with regard to the provisions of the *ITA*.

Considering that POOL was a "second successor corporation" and the amalgamation of POOL and Pan Alberta was governed by s. 87 of the *Act*, the FCA found that for tax purposes the respondent was deemed to be a "new" corporation and as a new corporation it was not the same entity as POOL. POOL and the respondent were considered separate taxpayers and there was no provision in the *ITA* that allowed one taxpayer to claim deductions for the oil and gas exploration expenses of another taxpayer. If the respondent had been either a first or second successor corporation, the deductions would have been allowed under subsections 29(25) and 29(29) of the *Income Tax Application Rules*,[105] but the FCA held the respondent was neither.

The trial judge also considered that para. 87(2)(a) did not deprive the respondent of the right to take the deductions. He had looked at the obiter analysis of the section in *R.* v. *Guaranty Properties Ltd.*,[106] and interpreted it to mean that the presumption of the section was limited solely to the timing of the new corporation's first taxation year. In the opinion of the FCA, however, the presumption was limited in scope and not applicable generally to the whole of the *ITA*. Section 87 fell under Division B of Part I of the *ITA* which dealt with the computation of income. In the view of the FCA therefore, the provisions of para. 87(2)(a) were applicable to the amalgamated company's computation of income, including deductions.

B. *EXCEL ENERGY INC.* v. *ALBERTA* [107]

This decision displays in a general sense that governmental royalty or other similar tax credits pertaining to the oil and gas industry might be claimed even if a party has a contingent working interest in the properties for which the credit is claimed.

The appellant, Excel Energy Inc., appealed under s. 50 of the *Alberta Corporate Tax Act*,[108] from notices of re-assessment issued by the respondent, the Province of Alberta, in respect of the appellant's 1987, 1988, 1989 and 1990 tax years, denying the Alberta Royalty Tax Credit ("ARTC") claimed by the appellant in each of the stated years.

The appellant, as farmee, entered into a farmout agreement with Drummond Oil and Gas Ltd. in 1987. Under the agreement, in exchange for incurring certain drilling costs,

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105 *Ibid.*

106 (1990), 90 DTC 6363 (F.C.A.).

107 [1995] 2 W.W.R. 220, 24 Alta. L.R. (3d) 164 (Q.B.).

108 R.S.A. 1980, c. A-17.

the appellant was to receive 15 percent of net revenues (which included a deduction of Crown royalty) generated by the Pouce Coupe Unit (the "Unit") until 125 percent of the drilling costs had been recouped from such revenues. Thereafter, the appellant was entitled to a participating interest in the Unit of approximately 1.5 percent. The appellant did not earn its participating interest until after the end of 1990 tax year. For each of the four tax years at issue, the appellant claimed as income the amount of royalty reserved to the Alberta Crown corresponding to its share of revenue from the Unit pursuant to para. 12(1)(o) of the *Income Tax Act.*[109] The relevant provisions of the paragraph are as follows:

> 12.1 There shall be included in computing the income of a taxpayer for a taxation year as income from a business or property such of the following *amounts* as are applicable:
>
> (o) any *amount* ... that, because of an obligation imposed by statute ... became *receivable* in the year by ...
>
> (i) Her Majesty in right of ... a province
>
> as a royalty ... and that may reasonably be regarded as being in relation to ...
>
> (v) the production in Canada
>
> (A) of petroleum, natural gas or related hydrocarbons from ... an oil well or gas well ...
>
> situated on property in Canada in which the taxpayer had an interest with respect to which the obligation imposed by statute ... applied [emphasis added].

As a result of the income claim, the appellant claimed entitlement to a corresponding ARTC pursuant to para. 26(1)(2) of the *Alberta Corporate Tax Act*. The parties acknowledged that the farmor did not claim the ARTC for these amounts. Subsection 26(1) of the *Alberta Corporate Tax Act* only allows the ARTC on amounts required to be included as income under para. 12(1)(o) of the *Income Tax Act*. The minister disallowed such claim on the basis that the appellant did not have to include as income the amounts declared under para. 12(1)(o) of the *Income Tax Act* and therefore did not have any claim to the ARTC.

The respondent also disputed the claim on the basis that the Alberta Crown royalty was not "receivable" from the appellant, but rather from those with actual working interests in the Unit.

Hart J. allowed the appeal and directed that the appellant's claims for the ARTC be allowed and accepted as originally filed. Hart J. stated:

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[109] R.S.C. 1985 (5th Supp.), c. 1.

> Thus, although ARTC is, in effect, a reduction of Alberta Crown royalty by the Crown in right of Alberta, intended as an incentive to producers who bear the burden of the non-deductibility of provincial royalty for federal income tax purposes, and although this incentive comes at the expense of the Alberta Crown share of production revenues, eligibility or entitlement to the incentive has been left to be determined solely by the wording of a federal tax statute, specifically, s. 12(1)(o) of the *Income Tax Act* of Canada.[110]

Hart J. then went on to comment that the above provision of the *Income Tax Act* is broadly worded and that:

> The phrase "receivable in the year by virtue of an obligation imposed by statute" does not require that the amount of royalty so receivable be paid by any particular party. Indeed, the word "payable" is not used. Alberta Crown Royalty is not "paid" per se but is "reserved" under the *Mines and Minerals Act*....
>
> In my view, therefore, the "amounts" of royalty are no more "receivable" from a working interest owner than they are from a farmee with an interest in net revenues. In both cases, the burden of the royalty is borne through a reduction in revenue which would otherwise be derived from the sale of production if the Crown royalty had not been reserved and was not "receivable" by the provincial Crown from the hydrocarbons produced from the reservoir.[111]

As a result Hart J. rejected the Crown's argument that the appellant was not liable for Crown royalty and that no "amount" of royalty was properly included for federal income tax purposes under s. 12(1)(o) of the *Income Tax Act.* Therefore, the appellant was eligible for the ARTC.

One final comment by the Court was that the definition of "property" in s. 248 of the *Income Tax Act* is extremely broad. By virtue of that section, the appellant was determined to have at least two "rights" under the farmout agreement: a right to net revenues from the Unit and a right to the future assignment of a working interest in the Unit. Therefore, the appellant was held as having an "interest" in "property in Canada" for all four taxation years within the meaning of both s. 12(1)(o) and s. 248 of the *Income Tax Act.*

VI. ENVIRONMENTAL

Although judicial developments in environmental law are beyond the scope of this article, we wish to note two decisions of particular interest:

A. *R.* v. *SUNCOR INC.*[112]

This decision is relevant to the factors the courts will consider when issuing sentences or fines for offences under the *Fisheries Act.*[113]

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110 *Supra* note 107 at 224.
111 *Ibid.*
112 (1995), 161 A.R. 149 (Prov. Ct.).
113 R.S.C. 1985, c. F-14.

In June 1992, a pipeline operated by Suncor ruptured on the bank of the House River and large quantities of diesel and naphtha spilled into the water. The rupture was a result of pressure building up in the pipeline when product was being pumped against a closed valve. The valve was closed prior to the rupture as part of a test for proper functioning. It was not reopened and no entry was made in the logbook to indicate the valve's closure.

Two main causes of the spill were identified. The first was an inexperienced operator who was on duty the evening of the spill. In addition, there was no requirement that the log maintained by the operator contain notes about valves being closed nor was there a standard of checking for closed valves. Secondly, the pipe failed due to a fatigue crack in welding that had been performed on the pipe in 1974 as part of a leak isolation and repair procedure.

The spill affected the terrestrial environment on the bank of the river as well as the aquatic environment. Alberta Fish and Wildlife investigated the area and found that fish populations downstream from the spill were 80 percent below what they were upstream from the spill site. Although the impact of the spill was severe, the fish and benthic communities recovered with minimal long-term effects.

Suncor pleaded guilty to an offence under s. 35(1) of the *Fisheries Act*. In determining a proper sentence, the Court looked at several factors and then balanced the aggravating or mitigating circumstances related to them. The Court also stated that deterrence is the most significant consideration in environmental sentencing. The following were the factors the Court considered:

(1) Nature of the Environment. The Court considered that the area of the spill was below the sensitive spawning area, and although the aquatic environment was fragile, it recovered quickly with minimal long term effects.

(2) The Extent of the Damage. Due to the rejuvenation of the fish populations and benthic communities the Court considered this a case of "alteration and disruption" of the habitat rather than "destruction."

(3) The Criminality of the Offence. The Court considered that none of the causes for the spill were wilful or conscious, but that the guilty plea acknowledged that the defence of due diligence was not available. The fact that Suncor's monitoring and maintenance, inspection and repair programs exceeded ERCB requirements was also considered.

(4) The Extent of Suncor's Attempts to Comply with the Law. Suncor complied with regulatory requirements by immediately notifying the ERCB and Alberta Environment about the spill. The response to the clean-up by the corporation was immediate, efficient and successful.

(5) Remorse. The guilty plea was a significant factor in the Court's consideration. Not only did it show remorse but it was a significant saving to the taxpayer.

(6) Size, and Wealth, of Suncor. The Court looked at the fact that in addition to its pipeline, Suncor has a huge oil sands operations. Suncor had been consistently profitable, had been in operation since the mid-1960s and, as of 1993, employed 1715 people. The spill was Suncor's first since 1974.

(7) Criminal Record. Suncor had two previous convictions with regard to its oil sands plant, but none in relation to its pipeline. The Court tempered the convictions with the reality that in a large operation such as Suncor's, accidents are bound to happen.

The Court penalized Suncor in the amount of $100,000. In addition to the above factors, the Court looked at cases cited by both parties, but found them to be useful only as general guidelines rather than as precedents. The Court emphasized that the penalty should not make light of the substantial environmental spill and it should deter both Suncor and others from allowing similar incidents. However, the penalty should also recognize the aspects of the total situation that reflect good corporate citizenship. In the Court's opinion, the offence fell in the top of the lower third of the continuum from *de minimus* to "worst case."

B. *R.* v. *TRI-LINE EXPRESSWAYS LTD.*[114]

Tri-Line Expressways Ltd. ("Tri-Line") appealed a conviction under s. 20(1)(a) of the *Transportation of Dangerous Goods Control Act.*[115] The transport company was found guilty at trial of failing to notify the police immediately upon being advised of a dangerous occurrence in respect of dangerous goods.

The company was holding large drums containing a corrosive and flammable substance in its Edmonton yard. Attached to each drum was a document certifying the dangerous nature of the contents. An employee noticed a discharge coming from one of the drums and reported it to Tri-Line's dispatcher. The dispatcher in turn notified the branch manager. At least thirty hours went by before the occurrence was reported to the appropriate authorities.

The appeal court looked at the purpose of the legislation, which is to ensure that authorities are notified in sufficient time for a proper investigation of the occurrence to be conducted, in the hope that future incidents may be avoided. By the time Tri-Line had notified the police, the drums had been removed to the manufacturer and were no longer available for investigation.

The appeal court agreed completely with the trial judge who had concluded the following: that Tri-Line was dealing with dangerous goods; that the company had the charge, management, or control of the particular goods; that they had discovered there was a dangerous occurrence; and that they failed to immediately notify the police. Tri-

114 [1995] A.J. No. 294 (C.A.) (QL).

115 S.A. 1982, c. T-6.5.

Line thereby committed the offence for which it was convicted and the appeal court upheld that conviction.

The trial judge had dismissed Tri-Line's argument that they were a manufacturing or processing facility, which would relieve them of the responsibility for the leak. In addition, the trial judge had found that the case for due diligence had not been made out, having regard to what Tri-Line knew or ought to have known, in particular because of the nature of the business it was in and the expertise it professed to have in the area.

The appeal court also agreed with the trial judge's finding regarding s. 9.1 of the federal regulations[116] for the *Transportation of Dangerous Goods Control Act*, which are incorporated into the Alberta *Act*. Section 9.1 defined "dangerous occurrence" as something that "represents a danger to health, life, property, or the environment." The trial judge had held that this did not mean that the Crown had to prove actual harm, only a risk of harm.

This decision emphasizes the importance of reporting dangerous or potentially dangerous spills to the proper authorities.

VII. TORTS

A. *VOGEL* v. *CANADIAN ROXY PETROLEUM LTD.*[117]

This case dealt with an appeal from an Alberta Provincial Court decision which appeared in last year's "Recent Judicial Developments" article.[118] The facts were as follows: one of Vogel's calves was killed when it got its head stuck between the wrist pin and the weights of Canadian Roxy Petroleum Ltd.'s ("Roxy") operating wellhead pumpjack. The calf was legally on the land because Vogel had a grazing lease. There was evidence that Roxy had erected a rudimentary fence around the pumpjack but it contained flaws that allowed the calf to enter the site. Vogel sued Roxy for the loss of the calf.

At trial, the judge found for Vogel and awarded damages. Because the case dealt with an animal and not a person, she found that the *Occupier's Liability Act*[119] was of no assistance and instead decided the case on the common law duty of care owed by an occupier or user of land. In order for Roxy to be liable, she held that it would have to have been negligent in its protection of those entering onto the land from any dangers present or reasonably foreseeable. She viewed the fact that Roxy had erected a fence as an indication of their knowledge about possible danger, and found that the fence was an inadequate structure. The damage, she stated, was reasonably foreseeable and Roxy was liable.

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116 SOR/85-77.

117 [1995] 3 W.W.R. 49 (Alta. Q.B.).

118 *Supra* note 102.

119 R.S.A. 1980, c. 0-3 [hereinafter *OLA*].

The appeal judge agreed with the result at trial. However, he did not agree that the *OLA* was not applicable. In his view, it was unnecessary to consider whether the visitor was a person or an animal because s. 14 in the general provisions of the *OLA* extended liability to loss of property. Notwithstanding this, the appeal judge did not rely on the *OLA* to decide the case. He looked to the mineral surface lease held by Roxy and in particular at s. 26(2) of the *Mineral Surface Lease Regulations*[120] which provided:

> [The] lessee is liable for all damage caused to persons, stock, vehicles, walls, fences, erections, structures, buildings, and property of any kind, by the lessee, his servants or agents or employees.

Although the appeal judge agreed that this provision did not give rise to a new category of liability, he stated that if liability could be found in negligence then the regulation and the lease in which it was contained would carry that liability to Roxy. In the appeal judge's opinion, there was ample evidence and grounds for finding a duty, a breach and damage in the case and the fact that it was a freak accident was not a reason to decide that it was not caused by negligence. He considered the accident to have been reasonably foreseeable and a result of Roxy's negligence. He also found no proof of contributory negligence. The trial judgment was upheld.

B. *SNC-LAVALIN INTERNATIONAL INC.* v. *LIQUID CARBONIC INC.*[121]

This case is interesting because it magnifies the importance of either ensuring the representations given in respect of products sold to others are limited to those specified in the contract or, by exercising reasonable diligence, ensuring that all representations are true.

The defendant, Liquid Carbonic Inc., successfully bid for the supply of certain types of welding electrodes for use by the plaintiff, SNC-Lavalin International Inc., for the welding of a pipeline being constructed. One of the welding electrodes requested to be supplied to the plaintiff had not previously been produced by the defendant. That type of electrode constituted the majority of the electrodes to be supplied to the plaintiff. The defendant did not advise the plaintiff that it had not previously manufactured that type of electrode and the plaintiff made no inquiries regarding the defendant's experience in manufacturing such electrodes.

The defendant attempted to fabricate the electrodes to meet industry specifications and, after delivery, provided the plaintiff with the certificate that industry standards had been met. However, none of the electrodes manufactured by the defendant were subjected to a welding test in the conditions under which they would be used (*i.e.* in the "vertical down" position). The electrodes manufactured by the defendant for the plaintiff were incapable of performing an acceptable weld.

After notifying the defendant of the problems with the electrodes and requesting replacement of all electrodes, the plaintiff then proceeded to order sufficient quantities

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[120] Alta. Reg. 292/87.

[121] (1995), 166 A.R. 296 (Q.B.).

of welding electrodes from another company to allow field welding of the pipeline to proceed.

The plaintiff sued the defendant for negligent misrepresentation. Of particular importance was that the plaintiff had ordered a specific type of electrode and also had informed the defendant as to the intended use of such electrodes.

Rowbotham J. incorporated the test for negligent misrepresentation as outlined by Iacobucci J. in *Queen* v. *Cognos Inc.*, which states:

> The required elements for a successful *Hedley Byrne* claim have been stated in many authorities, sometimes in varying forms. The decisions of this court cited above suggest five general requirements:
>
> (1) there must be a duty of care based on a "special relationship" between the representor and the representee;
>
> (2) the representation in question must be untrue, inaccurate, or misleading;
>
> (3) the representor must have acted negligently in making said misrepresentation;
>
> (4) the representee must have relied, in a reasonable manner, on said negligent misrepresentation; and
>
> (5) the reliance must have been detrimental to the representee in the sense that damages resulted.[122]

Rowbotham J. allowed the claim of the plaintiff on the basis that the above tests were met and held that the plaintiff was entitled to damages arising out of negligent misrepresentations made by the defendant.

C. *COLBORNE CAPITAL CORP.* v. *542775 ALBERTA LTD.*[123]

The facts of this case, as found by Virtue J., make fascinating reading. The case involved the competing interests of Colborne Capital Corporation ("Colborne") and Stampeder Exploration Ltd. ("Stampeder") to try to acquire the shares of Westar Petroleum ("Westar") from the Westar Group ("the Group"). Westar's assets were held by the Bank of Montreal, which had an option for 49.9 percent of the company's shares for the debt. Although Westar had no net worth on its face, it had $100 million in tax pools. Colborne gained the co-operation of Westar's chief financial officer, Thomas Pointer. Together they conspired to interfere with a public offering which Stampeder planned to issue to cover the cost of acquiring Westar's shares, as part of a fraudulent scheme to force Stampeder into making a deal to transfer the tax pools to Colborne. In reaching that conclusion, Virtue J. reviewed several pertinent areas of the law and, in the process, provided us with several of the most recent developments in the law.

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122 (1993), 99 D.L.R. (4th) 626 at 643 (S.C.C.).

123 [1995] A.J. No. 538 (Q.B.) (QL).

Colborne first tried to obtain a period of exclusivity in which to acquire Westar. It eventually put in place with Pointer a purported right of first refusal with Westar. As it became more and more desperate, it put together a board resolution of the numbered company which held the shares for the Group to support the supposed right of first refusal and a unanimous shareholders' agreement with the numbered company. It kept some of these weapons within its "arsenal," and kept them secret until after Stampeder had closed the purchase of the shares and was then preparing a stock issue to finance the purchase. Colborne then sprung on Stampeder its case for preferential rights, thinking that the suggestion that Stampeder might not have the right to close the purchase would jeopardize Stampeder's ability to attract and hold investors which, in turn, would bring Stampeder to heel. Colborne would then enter into a settlement whereby it would gain the tax pools and leave Stampeder with the oil and gas assets. When telephone calls from Colborne to Stampeder and from its lawyers to Stampeder's lawyers failed to evoke the desired response, Colborne issued a press release indicating it was seeking legal recourse to halt Stampeder's transaction. The statement of claim in this action was the next step.

Virtue J. systematically went through all of the plaintiff's arguments.

First, he made it plain that only the Group had the right to enter into an agreement which would interfere with its right to dispose of its property, the shares of Westar. He found that neither the Group nor the numbered company granted a right of first refusal.

Secondly, Virtue J. satisfied himself that Pointer had neither actual nor ostensible authority from the Group to grant a right of first refusal.

Thirdly, Colborne knew that Pointer and Westar had no authority to grant a right of first refusal and Virtue J. found that in the face of actual knowledge of lack of authority, it was not entitled to rely upon an allegation of ostensible authority.

The Court reviewed the duty of care owed by a director and officer under s. 117 of the *Alberta Business Corporations Act*,[124] which provides in part:

> Every director and officer of a corporation in exercising his powers and discharging his duties shall
>
> (a) act honestly and in good faith with a view to the best interests of the corporation....

Virtue J. determined quickly that the "interests of the corporation" in this instance were readily determined: the Group as the single shareholder and the Bank of Montreal as its only stakeholder held common and well known interests. The following quote is telling:

> At the very least, Pointer, as an officer and director, had an obligation not to deliberately use his powers as an officer and director, to have the corporation, without the knowledge of the sole

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[124] R.S.A. 1981, c. B-15 [hereinafter *ABCA*].

> shareholder, act in such a way as to interfere with the shareholder's rights with respect to its shares of the corporation.[125]

Further, s. 97(1) of the *ABCA* provides: "Subject to any unanimous shareholder agreement, the directors shall manage the business and affairs of a corporation."

But Virtue J. pointed out that the matter of granting a right of first refusal with respect to the Group's shares was not "the business or affairs" of the Westar corporation; it was the business or affairs of the Group and Pointer was not a director of that company. This was not a situation where a director was dealing with the yet to be issued share capital of a company of which he was a director. Here he was purporting to have the corporation of which he was a director deal with the shares owned by another entity.

Although Virtue J. found that the unanimous shareholders' agreement was put in place simply as a further means of pressuring Stampeder to do a compromise deal with Colborne, he did provide an interpretation of the definition of "unanimous shareholders' agreement" as it is found in s. 1(2) of the *ABCA*, which reads as follows:

> "Unanimous shareholder agreement" means
>
> (i) a written agreement to which all the shareholders of a corporation are or are deemed to be parties, whether or not any other person is also a party, or
>
> (ii) a written declaration by a person who is the beneficial owner of all the issued shares of a corporation,
>
> that provides for any of the matters enumerated in section 140(1)....

Virtue J. expressed the view that clause (ii) and not clause (i) was intended to govern where there is only one beneficial owner of all of the issued capital of a company. The declaration by the single shareholder is a simple, practical method to evidence approval of a single shareholder.

Finally, Virtue J. found the purported unanimous shareholders' agreement to be unenforceable because it was created for an unlawful purpose (*i.e.* to "fraudulently impose legal obligations on [the numbered company] in an effort to thwart the legitimate purchase and sale transaction between Stampeder and the Group").[126] *Zimmerman* v. *Letkeman*[127] was cited with approval.

Justice Virtue spent little time in dismissing a claim by the plaintiffs that Stampeder and the Group had interfered with their contractual relations.

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125 *Supra* note 123 at para. 247.

126 *Ibid.* at para. 271.

127 [1978] 1 S.C.R. 1097.

The Court adopted the statement of law with respect to the tort of interference with contractual relations found in Berger J.'s judgment in *Ed Miller Sales & Rentals Ltd.* v. *Caterpillar Tractor Co.*[128] Fleming is cited there with approval:

> Liability will attach if the intervenor, with knowledge of the contract and intent to prevent or hinder its performance, either (i) persuades, induces or procures one of the contracting parties not to perform his obligations, or (ii) commits some act, wrongful in itself, to prevent such performance. The first is usually described as "direct", the second is "indirect" interference....[129]

In finding the plaintiffs had failed to prove the existence of a valid and enforceable contract with the Group, with the numbered company or with Westar, Virtue J. denied the claim under that head. He similarly dismissed the plaintiffs' claim for unlawful interference with another's economic interests. He cited the *Ed Miller* case to say that it is now a recognized tort in Canada, but he cautioned that the courts must clearly distinguish between the tort of interfering with economic interests and what should be regarded as fair competition in a free enterprise economy. The essence of the tort is stated succinctly by Locke J. in *International Brotherhood of Teamsters* v. *Therien*: "you are not entitled to interfere with another man's method of gaining his living by illegal means."[130]

(We would be inclined to say that only the police should do that, but what Locke J. meant, we suggest, was you are not entitled to interfere by illegal means with another person's method of gaining a living.)

Virtue J. said:

> [even if] the plaintiffs had, by proper means, elevated their position to a valid economic interest which the court would protect, I am satisfied that there was no act of unlawful interference by the defendants.[131]

The reverse was true when Virtue J. looked at the counterclaim by Stampeder:

> The defendants by counterclaim [Colborne *et al.*] intentionally sought to injure Stampeder's valid economic interest: the right to raise funds on the public market. The means employed were fraudulent and unlawful, and caused Stampeder damage.[132]

It is perhaps useful at this point to go through the rest of the counterclaim. Virtue J. laid out the three elements of fraud: (1) dishonest conduct; (2) an intention to deceive; and (3) damages suffered by the innocent party. To determine if conduct complained of is dishonest, an objective standard is employed. "It is conduct which a reasonable, decent person would consider dishonest."

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128 [1994] 5 W.W.R. 473 (Alta. Q.B.) [hereinafter *Ed Miller*].
129 J.G. Fleming, *The Law of Torts*, 7th ed. (Sydney: The Law Book Co. Ltd, 1987) at 653.
130 (1960), 22 D.L.R. (2d) 1 at 13 (S.C.C.).
131 *Supra* note 123 at para. 345.
132 *Ibid.* at para. 373.

Virtue J.'s finding is clear:

> [T]he actions of Grenon and Pointer constitute fraud. They wilfully conspired to deprive Stampeder by inequitable means of its right to complete its financing on the public market. Any reasonable, decent and objective business person, fully acquainted with the facts would consider their conduct dishonest and fraudulent.[133]

Virtue J. reviewed the discussion on the tort of conspiracy as found in Berger J.'s decision in the *Ed Miller* case. He derived the point that the key to the recognition of the tort of conspiracy is to determine the purpose or object in the minds of the alleged conspirators when they acted as they did. He found that the predominant purpose of the action of Messrs. Grenon, Edwards and Pointer, working together, was to injure Stampeder. The tort of conspiracy was found.[134]

The last cause of action under the counterclaim upon which we should comment is that of abuse of process. Virtue J. referred to a discussion of this tort in the decision of Fruman J. in *The Rocky Mountain Rail Society* v. *H&D Hobby Distributing Ltd.*[135] Although that case, too, failed to come to our attention in time to be analyzed in depth in our article, we wish to echo Virtue J.'s assessment that it does contain a good review of the law on abuse of process. In her judgment, Fruman J. indicates the two elements which constitute the tort:

> [F]irst, there must be an improper purpose which is outside the ambit of the litigation; secondly, there must be a definite act or threat in furtherance of that purpose. If one or both of these elements is absent, it is then beyond doubt that the [counterclaim] is doomed to failure.[136]

The tort requires the use of court proceedings for an improper purpose and proof of definite actions in furtherance of such a purpose. Colborne was attempting to compel Stampeder to make a deal with Colborne for the transfer of Westar's tax pools, which was clearly outside the scope of the action itself. Stampeder was not required to prove that Colborne lacked reasonable and probable grounds for initiating the action. It was enough to demonstrate the ulterior motive for the action in order to establish the tort of abuse of process.

A word about damages under the counterclaim: the measure of the pecuniary loss was taken by using the average price actually attained by similar stocks on the date the stock warrants issued. Thus, it was not a prediction of what Stampeder's particular stock might do in the future but was based upon hindsight looking at what equivalent stocks did. Virtue J. was guided by *McGregor on Damages*[137] in heeding the warning that "care must be taken not to assess the value of the shares at the price at which they stand in the market since such a price may be a false and artificial one induced by the

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133 *Ibid.* at para. 365.

134 *Ibid.* at para. 367.

135 [1995] A.J. No. 228 (Q.B.) (QL).

136 *Ibid.* at para. 19.

137 15th ed. (London: Sweet & Maxwell Ltd., 1988) at para. 1725.

very deceit of which the plaintiff is complaining. ... The actual value is, therefore, the price the shares would fetch in the market if the truth was [sic] revealed and all the fact [sic] were known."

But in awarding punitive damages against the defendants by counterclaim, Virtue J. had this to say:

> The conduct of the defendants-by-counterclaim has been motivated by jealousy and greed. It has encompassed the torts of conspiracy and abuse of process. The conduct has so far exceeded the bounds of ordinary corporate morality as to warrant an award of punitive damages designed to make a statement to the business community that the courts of civil law will not condone excessive conduct of this kind nor tolerate an abuse of the Court process.[138]

He felt an award of $1 million would suffice for the message the Court wished to convey. This amount is some five times the amount ordinarily awarded for punitive damages in Canada.

The last issue from Virtue J.'s judgment we should touch upon is the allegation of conflict of interest which Colborne brought against Stampeder and Peter Williams. Williams became a vice-president of Stampeder, but at the material times he was a partner at Bennett Jones Verchere, as was Alan Ross, a tax lawyer with that firm. Ross was retained to provide tax advice to Grenon respecting a possible restructuring of Westar and, in the course of so acting, Ross became privy to the banking and tax details of Westar. Williams was aware of this, and when Stampeder also sought tax advice, Williams asked Ross to obtain clearance from his client, Grenon, so that Ross could be free to advise Stampeder. Ross never got the clearance, and in the course of discussions with Stampeder, he revealed the information with respect to Westar which Grenon had furnished to him. Colborne did not pursue Ross but did pursue Williams and Stampeder for breach of confidence. In finding no causal link between the disclosure of Westar's tax pools and the losses alleged by the plaintiffs, Virtue J. commented that the fact that the plaintiffs singled out Williams as the defendant rather than Ross cast doubt upon the *bona fides* of their claim. He found a breach of Williams' duty owed as a solicitor to his client, but determined there was no unauthorized use of the information to the detriment of the plaintiff and, therefore, no remedy.

He reviewed LaForest J.'s judgment in *Lac Minerals*[139] and concluded:

> I am satisfied that a breach of duty of confidentiality, whether it arises in contract or in tort, cannot produce a remedy for the plaintiff against the confidant (here Williams), unless it is shown by the plaintiff that the confidential information was used by the confidant himself or that it was, as a result of some action by the confidant, used by a third party *to the detriment of the confider*. There must be

[138] *Supra* note 123 at para. 394.
[139] *Supra* note 45.

an unauthorized use of that information to the detriment of the party communicating it before there can be a remedy.[140]

The judgment of Virtue J. contains a good review of the lawyer's duty to his client. He reviewed the Sopinka J. judgment in *MacDonald Estate* v. *Martin* (more commonly referred to as *Martin* v. *Gray*).[141] Although that case goes in great depth into a discussion of "Chinese walls" and "cones of silence" and led to the recent amendments to the Alberta *Code of Professional Conduct*,[142] the main premise remains unaffected: "A lawyer who has relevant confidential information cannot act against his client or former client. In such a case the disqualification is automatic."[143]

Virtue J. referred to another unreported recent case, *Gainers Inc.* v. *Pocklington*[144] which contains a good review of the new *Code of Professional Conduct*. Côté J. made the point that codes of professional conduct governing lawyers do not govern the court, which must follow the law governing fiduciaries and confidences, not rules of professional ethics. He looked at the new *Code of Professional Conduct* and then summed up three rules which he found applicable to disqualify a law firm from acting:

(1) A law firm cannot act for a client when it has a present but conflicting interest.[145]

(2) Maybe a law firm cannot act against its former client in the same or any related matter.[146]

(3) A law firm cannot reveal to unauthorized persons confidential communications.[147]

There was a clear finding of breach of confidence against Ross and Williams, but no action was brought against Ross and no remedy was applied against Williams.

VIII. SURFACE RIGHTS

A. *FERGUSON* v. *RANGER OIL LIMITED*[148]

This case is beneficial since it outlines the importance of some of the factors the Surface Rights Board (the "Board") must consider when making a determination respecting awards of compensation in respect of general disturbance and adverse effect.

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140 *Supra* note 123 at para. 322 [emphasis added].
141 [1990] 3 S.C.R. 1235, 77 D.L.R. (4th) 249 [cited to S.C.R.].
142 Rule 2, Commentary 2.3 at 58.
143 *Supra* note 141 at 1261.
144 [1995] A.J. No. 438 (Q.B.) (QL).
145 *Michel* v. *Lafrentz* (1992), 120 A.R. 355 (C.A.); 1994 Alberta *Code of Professional Conduct*, c.6 rr. 1, 2, 6 & 7.
146 1974 *CBA Code*, c. 5, Comm. 8; but the 1994 *Alberta Code* does not bar this as such.
147 1994 *CBA Code* c. 4; 1987 *CBA Code*, c. 4; 1994 *Alberta Code*, c. 7, rr. 1, 5, 6, & 7.
148 [1995] A.J. No. 293 (Q.B.) (QL).

As a result of a number of right of entry orders granted by the Board in March 1994, the appellants and the respondent, Ranger Oil Limited, attempted to negotiate compensation to be paid for the loss of the value of the land, the ongoing loss of use of the land, general disturbance to the land during the first year that the well was put on the site and the ongoing adverse effect to the land during the currency of the presence of the wellsite. Agreement was not reached, with the result that a compensation hearing was required to be held by the Board. Such hearing was held on June 29, 1994, and a decision was delivered by the Board on August 16, 1994.

After reviewing the decision of the Board, the appellants determined the compensation awarded for the taking of the land and for the loss of use of the land was satisfactory. However, they were of the view that the compensation provided for general disturbance and adverse effect was not adequate. Therefore, the appellants appealed the latter portion of the decision of the Board and requested the Court of Queen's Bench to vary the Board's decision.

In particular, the appellants argued that the Board failed to consider a "discernible pattern of dealings present within the general area between owners and operators." Hembroff J. of the Court of Queen's Bench allowed the appeal and directed that the compensation order in respect of general disturbance and adverse effect be varied in accordance with the evidence of the appellants.

Hembroff J. outlined the appeal process set forth in s. 26 of the *Surface Rights Act*[149] and confirmed that the options of the Court were to either confirm the order of the Board or direct that compensation be varied. In this regard, note that the Court, pursuant to s. 26(7)(a) of the *Surface Rights Act*, has the same power and discretion as the Board in determining the amount of compensation payable. The matters which the Board may consider in determining compensation are set out in s. 25 of *Surface Rights Act*.

Hembroff J. acknowledged that the evidence presented on the part of both the operator and the owners with respect to general disturbance and adverse effect was largely empirical. Further, he acknowledged that it appeared that there was no evidence nor any discussion that a pattern of negotiated leases had been established in the area. However, while the empirical approach was the only one put before the Board and was described by the Board in its decision, the Board did not follow such an approach.

Hembroff J. then commented that the generally accepted position is that the market determines compensation and that the "pattern of dealings" approach seems to be the most common basis upon which the industry deals.

The Court reviewed the case of *Caswell* v. *Alexandra Petroleums Ltd.*[150] and stated that even though an appeal before the Court is in the nature of a *trial de novo*, the decisions of the Board were also relevant:

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149 R.S.A. 1980, c. S-27.1.

150 [1972] 3 W.W.R. 706 (Alta. S.C.A.D.).

> When they make detailed findings of fact, as they did in this case, after viewing the area and hearing representations from both sides, and render written reasons as extensive as they did in this case, I think that their findings should not be lightly disturbed. In other words I think it would require cogent evidence to establish where they were wrong and why their awards should be varied or revised upward or downward.[151]

Hembroff J. also stated that if the Board has certain information available and intends to use it for the purpose of making its decision, an opportunity to contradict and respond should be given to both the owners and the operator. The Court held that this opportunity was not given.

He then referred to objections made by the respondent in respect of evidence as to certain leases which came into existence in 1994, *after* the Board heard the appellant's application. In this regard, Hembroff J. stated:

> Obviously, even if the Board had actually considered a pattern of dealings as does not appear to be the case, it could not have considered leases that had not yet come into existence. However, it does appear as if I can do so at this time. I would nevertheless emphasize I have limited my view of the subsequent leases to the extent that they have supported the overall approach and conclusion of Berrien concerning valuation within the "neighbourhood" he observed.[152]

The Court also went on to state that the actual leases surveyed by the appellants' expert or the landowners themselves named in such leases did not have to be presented in Court where such expert had attended at all the wells and had, where necessary, discussed matters with varying landowners. When responding to the respondent's arguments that low weight should be given to the expert opinion where such evidence is not presented, the Court stated that it is necessary to have evidence concerning negotiated settlements before the Board or the Court and that "not to consider that evidence would be an error in law." The Court emphasized the importance of the expert to testify that he or she examined all the properties or leases in respect of which such valuations were based.

On the evidence, the Court concluded there was a pattern of negotiated deals.

Next, the Court had to decide the issue of whether to disturb the awards of the Board. Hembroff J. stated that such awards should be disturbed for the following reasons:

(1) The Board settled the award for general disturbance based on "evidence in the Vulcan area" without any such evidence being before it.

(2) The Board settled the adverse effect award by reference to "practice of most land owners and operators in the province" without any indication as to where that information came from.

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151 *Ibid.* at 728.

152 *Supra* note 148.

(3) If the Board relied on this information as being its own knowledge, and if the Board intended to use that information to come to its decision, the failure of the Board to advise the parties, particularly the owners, that it intended to make its decision on that basis was a failure of fairness to them.

(4) Most importantly, the Board failed to react to a pattern of negotiated dealings in the area immediately surrounding the fourteen disputed wellsites. In doing so, it failed to disclose any cogent reason or in fact any reason why it acted in this way. In doing so, it failed to act upon commonly accepted rules used in determining compensation.

At this point, Hembroff J. stated that it would be useful if there were a provision in the *Surface Rights Act* to allow him to merely conclude that the Board did not act in accordance with its mandate and then return the matter to the Board for calculation of the appropriate compensation to the landowners for general disturbance and adverse effect. He further stated that this would have the effect of maintaining the position that the Board is best suited to deal with such claims. However, since there was no such provision in s. 26 of the *Surface Rights Act*, Hembroff J. felt compelled to substitute his view for that of the Board. He accordingly incorporated the expert evidence of the appellants into his calculations.

IX. OFFSHORE DRILLING

A. *BOW VALLEY HUSKY (BERMUDA) LTD.* v. *SAINT JOHN SHIPBUILDING LTD.*[153]

In 1987, a fire broke out in the Bow Drill 3, a semi-submersible drilling rig owned by the first appellant, Bow Valley Husky (Bermuda) Ltd. ("BVHB"). BVHB had contracts with the second and third appellants, being Husky Oil Operations Ltd. ("HOOL") and Bow Valley Industries Ltd. ("BVI"), to provide drilling services at locations off the east coast of Canada. At the time of the fire, the rig was drilling an exploratory well on the Grand Banks of Newfoundland. The resulting damage prevented the rig from operating for several months during which BVI and HOOL continued to pay their rates to BVHB, which they alleged they were required to do under the terms of their respective agreements.

The Bow Drill 3 was constructed by the first respondent, Saint John Shipbuilding Limited ("SJSL"), using certain materials manufactured and supplied by the second respondents, Raychem Corporation and Raychem Canada Limited (collectively called "Raychem"). After the fire, the appellants commenced an action against SJSL for breach of contract and negligence, and against Raychem for their negligence. At trial, Riche J. found the plaintiffs (appellants) to be 60 percent at fault and the defendants (respondents) 40 percent at fault. However, he denied all claims of the appellants on the grounds that maritime law was applicable, which law barred contributory negligence.

153 [1995] N.J. No. 150 (S.C.A.D.) (QL).

Of the many issues raised by the appeal and cross-appeals, the issues discussed below are noteworthy.

The trial judge had found that a joint venture existed between the rig owner, BVHB, and the parties contracting for the rig, HOOL and BVI, and therefore the contributory negligence of BVHB could be attributed to the members of the joint venture which would negate the prospect of HOOL and BVI arguing that they were entitled to full recovery against the respondents without attribution of negligence.

The Court of Appeal rejected the joint venture concept indicating that clearly the only joint venture that did exist would have been as between the oil company group of operators and non-operators. The Court of Appeal also set out criteria as to when parties may be said to be in a relationship of either a joint or common venture.

Further, Cameron J.A. stated:

> HOOL and BVI do not have a joint property interest in the Bow Drill 3 which was solely owned by BVHB. Even if BVI and HOOL were the shareholders of BVHB, which they were not, shareholders are not considered the owners of the property of companies in which they hold shares.[154]

The Court of Appeal went on to discuss the principle of piercing the corporate veil and whether attribution of fault based on the relationship among the appellants could be found.

Cameron J.A. could see no basis upon which to pierce the corporate veil. In her reasons, Cameron J.A. commented that BVHB was not a sham since it was established for a valid business reason (*i.e.* to obtain financing). Additionally, there were no allegations of fraud or improper conduct by any shareholder of BVHB.

The Court of Appeal rejected SJSL's argument that, in the circumstances, the corporate veil might be pierced on the "group enterprise" principle. Such principle is recognized in the United States and is based on the existence of a parent-subsidiary relationship, the subsidiary corporation being one in which another corporation (the parent) holds more than 50 percent of the voting shares in the subsidiary. The Court of Appeal responded by stating that the parent company of BVHB was BVHOH and that HOOL never held the majority of shares of BVHOH — BVRS held such shares. Further, at the time of the fire, BVI owned only 41.5 percent of the shares of BVRS. Therefore, Cameron J.A. held that at the time of the fire neither BVI nor HOOL held the control of BVHB, either directly or through other companies. Furthermore, evidence provided regarding the overlapping of the directors between the various companies did not support the exercise of the type of control necessary to justify piercing the corporate veil.

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[154] *Ibid.*

In light of the Court of Appeal's conclusion that there was no joint venture and that the corporate veil could not be pierced, it became necessary to determine whether HOOL or BVI could maintain an action against the respondents, or any one of them.

In November 1985, SJSL wrote a letter to BVHB providing for full and final settlement of the construction contract and its warranty provisions. BVHB signed such letter, acknowledging satisfaction with that full and final settlement. Cameron J.A. held that the requirements for accord and satisfaction were met by such letter and that the parties intended to dispose of the contract and their rights thereunder (with one exception not relevant to the appeal). As a result, the Court of Appeal held that BVHB had no action for breach of contract. However, the Court went on to say that this accord and satisfaction did not waive any rights to an action framed in tort. More specifically, Cameron J.A. agreed with the trial judge that the provisions of the contract did not contradict the duty to warn.

In respect of the duty to warn, the trial judge was of the opinion that the respondents were negligent in failing to warn of the flammability of a wrap installed to prevent moisture from contacting certain insulation. This wrap had contributed to the severity of the fire. Both respondents argued that BVHB was aware of the flammability of the wrap and thus there was no duty, or if a duty existed, it was discharged. In this regard, Cameron J.A. stated:

> It is also clear that the duty to warn is owed by more than the manufacturer. The duty to warn has been extended to, among others, distributors, installers and repairers.... There was ample evidence upon which the trial judge could conclude that both Raychem and SJSL were aware that Thermaclad (the wrap) was not flame retardant. Further, both knew of the problems being encountered in finding properly functioning ground fault circuit breakers and of the propensity of the heat trace system to arc in certain circumstances. Both SJSL and Raychem had a duty to warn. There is no basis upon which to disturb the findings by the trial judge.[155]

The Court of Appeal stated that there was no evidence that either SJSL or Raychem advised the appellants of the flammability of the wrap, even though the trial judge found that some personnel with the plaintiffs knew that the wrap was flammable, given the occurrence of a number of small fires in 1984. However, the Court of Appeal held such observations were not sufficient for the respondents to validly raise the defence of voluntary assumption of risk. Further, the fact that the ground fault circuit breaker system was not working and known to SJSL and Raychem made the issuance of the warning more imperative and the duty to warn would exist even had there been functioning ground fault circuit breakers. Raychem argued that having advised SJSL of the flammability of the product, Raychem had fulfilled its duty. The Court of Appeal rejected this argument and specifically stated that the duty to warn was owed by Raychem to the ultimate consumer (*i.e.* BVHB).

In terms of to whom the duty was owed, the Court of Appeal stated that the manufacturer has a duty to warn everyone whom the manufacturer might reasonably

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155 *Ibid.*

foresee as being injured as a result of its negligence. Further, even if the manufacturer owes no duty to warn certain persons, it does not mean that the manufacturer owes no duty of care to such persons.

Another interesting point was the application of the "thin skull" principle. The trial judge found that residue and dirty cables aided in the propagation of the fire independent of the Thermaclad wrap. The trial judge attributed fault for the residue to the appellants. BVHB submitted that the trial judge erred in attributing liability to BVHB for the residue and dirty cables. The presence of residue on the cables should be seen as part of a working drilling rig and, on the application of the "thin skull" doctrine, the tortfeasor must take the victim as he finds him. The Court of Appeal responded by stating that the issue is more properly analyzed on the basis of whether the presence of residue or dirty cables is contributory negligence. However, the Court of Appeal found no evidence as to the source of the residue nor was there any suggestion that the cleaning standard on the rig was below that which might be appropriate. Therefore, there was no basis upon which the trial judge could conclude the appellants were negligent because of the presence of the residue and it could not be used to reduce the quantum of damages to which the plaintiff might otherwise be entitled.

The Court of Appeal, consistent with the minority view in the *Canadian National Railway Co.* v. *Norsk Pacific Steamship Co.*[156] indicated a fairly narrow right of recovery of contractual relational economic loss unless there was a high degree of actual knowledge or foreseeability on the part of the respondents of the risk that parties in the position of HOOL and BVI would suffer the type of damages they would incur in terms of interference with their contractual rights.

In respect of the issue of contributory negligence, Cameron J.A. held that there was ample evidence to support the findings that BVHB was negligent in operating the heat trace without ground fault circuit breakers and also given that other smaller fires occurred prior to the fire complained of. The Court of Appeal rejected BVHB's argument that it could not reasonably foresee the damage without the knowledge of the flammability of Thermaclad and that a finding of contributory negligence was supportable. As a result, the Court of Appeal did not disturb the trial judge's finding of contributory negligence against BVHB.

The Court of Appeal rejected SJSL's application of the doctrine of last opportunity or last clear chance to deny any recovery in cases of contributory negligence. Specifically, Cameron J.A. rejected the argument of SJSL that the appellants had the last clear chance to prevent their loss.

In respect of the application of maritime law, the Court of Appeal acknowledged that it did apply. This finding was based on a number of factors including that the Bow Drill 3 was registered in Bermuda and classified in the same way that a ship would be. Further, the fire occurred while the rig was working offshore. Finally, it was not

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156 [1992] 1 S.C.R. 1021.

necessary that the products manufactured by SJSL and Raychem were not manufactured exclusively for maritime use.

Therefore, Cameron J.A. could find no error in the trial judge's conclusion that maritime law was applicable to this case. However, Cameron J.A. went on to state that the law of the Province of Newfoundland was applicable in respect of the contributory negligence issue to the extent that there was no conflict with maritime law. In the alternative, Cameron J.A. stated that even if she were wrong in her application of the provincial law, she stated that she would refuse to apply the common law contributory negligence bar applicable in Canadian maritime law in any event since application of such bar would result in injustice. Cameron J.A. commented that apportionment of fault has been a tradition of maritime law in collision cases and that extension of that tradition to the present circumstances would be logical.

However, notwithstanding the above findings, Cameron J.A. did not interfere with the apportionment of liability between the appellants and the respondents at 60 percent and 40 percent, respectively.

X. CREDITORS' RIGHTS

A. *NOVA SCOTIA BUSINESS CAPITAL CORP.* v. *COXHEATH GOLD HOLDINGS LTD.*[157]

This case is interesting because persons holding security interests in petroleum and natural gas titles will attempt to apply this decision when arguing against a royalty interest as being an interest in land.

In 1986, Forgeron assigned to the defendant, Coxheath Gold Holdings Ltd. ("Coxheath"), the right to earn a 100 percent working interest in certain mineral claims represented by exploration licenses granted to Forgeron under the Nova Scotia *Mineral Resources Act*,[158] subject to the reservation of a royalty. The policy of the Department of Mines did not permit official transfers of exploration licenses to show any royalty or other partial interests in the land subject to the licences. The transfer document to Coxheath did not refer to the royalty reservations. Forgeron then transferred its royalty interests to three transferees who filed caveats with the Registrar of Mineral Rights between 1991 and 1993. Coxheath defaulted on a loan granted by the plaintiff, Nova Scotia Business Capital Corp., and went into receivership. The plaintiff applied to the province's Supreme Court for a determination of the priority of the royalty interests claimed by the transferees, as appellants. If the royalty interests were contractual in nature, the licences could be transferred by the appointed receiver to a third party free of the royalty interests. At trial, the Court held that the royalty interests as evidenced by the caveats did not constitute interests in land but were contractual in nature and accordingly the receiver could dispose of the mining interests free from any rights claimed by the appellants. On appeal, the Nova Scotia Court of Appeal upheld the trial

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[157] (1995), 135 N.S.R. (2d) 259 (C.A.).

[158] S.N.S. 1975, c. 12.

decision, largely incorporating the decision of the Supreme Court of Canada in *Saskatchewan Minerals* v. *Keyes.*[159]

When determining whether the interest in the licence was a proprietary interest, the Court reviewed the provisions of the *Mineral Resources Act.* Jones J.A. stated that there was nothing in the *Act* which indicated that the legislature intended to confer proprietary rights in the lands or minerals covered by the licence. In particular, the Court noted that the original licences issued to Forgeron gave him the right "to search for and prospect" for minerals and did not grant any proprietary right in such minerals. The Court also stated that the Minister of Natural Resources did not consent to the transfer of the royalty interests from Forgeron to the appellants and in fact advised that the ministry did not recognize the transfer of partial interests in licences. Further, the transfers of licences from Forgeron to Coxheath made no reference to the royalty interests reserved.

The Court did not think it was necessary to decide whether a mining lease confers an interest in land, since Forgeron did not hold an interest in land under the licences and therefore could not confer such an interest in assigning the royalty rights to the appellants.

Finally, the Court would not grant rectification of the agreement between Forgeron and Coxheath to establish a royalty interest in the land. The Court was of the opinion that rectification of the agreement would in fact create an interest greater than which Forgeron conveyed to the appellants, which, as stated above, could not and did not convey an interest in land.

XI. ADMINISTRATIVE LAW

A. *CENTRA GAS ALBERTA* v. *THREE HILLS (TOWN)*[160]

This case dealt with Centra Gas Alberta's ("Centra's") application for leave to appeal a decision of the Public Utilities Board ("the Board"). Centra owned and operated a natural gas utility that served Three Hills (the "Town"). The franchise agreement between Centra and the Town was approved by the Board on October 29, 1984. The term of the agreement expired on September 25, 1989, and under clause 12, unless the Town provided written notice of its intention to purchase the utility by June 27, 1989, the agreement was renewable for a further ten years. The Town did not give notice of an intent to purchase before the deadline, and there was no specific approval of the renewal given by the Board. In January 1993, the Town applied to the Board to fix the price of the utility pursuant to s. 281(2) of the *Municipal Government Act*,[161] which reads as follows:

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159 [1972] S.C.R. 703, 23 D.L.R. (3d) 573.
160 (1995), 162 A.R. 144 (C.A.).
161 R.S.A. 1980, c. M-26 [hereinafter *MGA*].

Any such contract entered into pursuant to section 279(1) or section 280, whether or not it contains an express provision to that effect, is subject to the following conditions:

(a) that the contract or special franchise conferred in respect thereto may not be altered or renewed without the approval of the Public Utilities Board;

(b) that any renewal may be for a period not exceeding 10 years from the expiration of the contract;

(c) that, if either party refuses to renew the contract, or if the parties fail to agree as to the conditions of renewal, then the council, subject to the consent of the Public Utilities Board, may purchase all the rights of the contractor in all matters and things under the contract and in all apparatus and property used for the purposes thereof, for the price and on the terms that may be agreed on with the contractor or failing agreement, then for a price and on the terms fixed and settled by the Public Utilities Board on the application of either of the parties.

The Town's application was put on hold while Centra applied to the Court to determine whether the Board had the jurisdiction to interpret the franchise agreement between Centra and the Town. That application appeared in last year's "Recent Judicial Developments" article.[162] The Court held that the Board had the authority to determine whether there had been a renewal of the contract, whether the Town had a right to purchase the utility, and whether clause 12 of the franchise agreement imposed a valid and binding condition requiring the Town to give at least ninety days notice before it could seek an order from the Board.

With regard to those issues, Centra argued that clause 12 presupposed a renewal based on the deadline for the Town's option to purchase, which the Town did not exercise. They also stated that the parties had actually agreed to the conditions of renewal when they incorporated clause 12 of the agreement. For this reason they argued that s. 281(2)(c) was not applicable as it was only for situations where the parties could not "agree as to the conditions of renewal." In addition, Centra stated that since the Board had approved the agreement in 1984, it had also approved the terms of renewal and therefore the agreement was binding.

The Board held that the effect of s. 281(2)(a) was that the Board's approval was required for the renewal of the contract, regardless of the renewal provisions in clause 12. Further, the Board interpreted the word "conditions" in s. 281(2)(c) to mean "terms" and not "conditions precedent" and therefore concluded that the parties had not come to an agreement on conditions of renewal. Since the Board was only prevented from setting a price if the parties had already done so, it was within their authority to set a price.

[162] *Supra* note 102.

Centra applied for leave to appeal the above decision pursuant to s. 62 of the *Public Utilities Board Act*.[163] To determine whether leave should be granted the Court applied a twofold test: does the decision of the Board involve a question of law or jurisdiction and, if so, is that question reasonably arguable? In the view of the Court, there were four issues of law and jurisdiction that arose from the Board's decision: (1) the Board's interpretation of s. 281(2)(a) of the *MGA*; (2) the Board's failure to consider whether it approved the renewal when it originally approved the agreement; (3) the Board's interpretation of s. 281(2)(c) of the *MGA*; and (4) the Board's interpretation of s. 28(3) of the *PUB Act*. The Court did not find the first issue reasonably arguable but found that the other three were, and leave to appeal was granted on those issues.

B. *TODD RANCH LTD.* v. *ALBERTA (SURFACE RIGHTS BOARD)*[164]

Todd Ranch Ltd. ("Todd") had a surface lease agreement with Inverness Energy Ltd. ("Inverness"). In March 1992, Alberta Environmental Protection conducted a reclamation inspection of the land at the request of Inverness. The inspection failed and, despite this, Inverness decided to terminate the lease. The termination was not accepted by Todd. In addition, Inverness refused to pay any more rent to Todd under the lease.

Todd filed an application with the Surface Rights Board under s. 39 of the *Surface Rights Act*,[165] seeking compensation for the rent payments. Section 39 reads as follows:

> (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 by the Board, settlement discussions were held at which some of the Board members were present. Todd declined the settlement offer made by Inverness.

The Board refused to grant relief to Todd. As reasons for its decision, it stated that the intent of the *Act* was not to compensate where there is a valid reason for withholding payment (*i.e.* the termination of the lease). In addition, it stated that the intent of the *Act* was "not to reward the likes of people who have apparently become entrenched in an unreasonable position on the assumption that Provincial Treasurer will

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163 R.S.A. 1980, c. P-37 [hereinafter *PUB Act*].

164 [1995] A.J. No. 279 (Q.B.) (QL).

165 R.S.A. 1980, c. S-27.1.

automatically be directed to pay."[166] This was in reference to Todd's refusal of the settlement offered by Inverness.

Todd applied for judicial review on four different grounds. The first was reasonable apprehension of bias on the part of the Board. The Court applied the test as set out by the Supreme Court of Canada in *Newfoundland Telephone Co.* v. *Board of Commissioners of Public Utilities*[167] — whether a reasonably informed bystander could reasonably perceive bias on the part of an adjudicator. The Court looked at the reasons cited by the Board for its decision and focused on the comments made about Todd being unreasonable in not accepting the settlement offer. In the Court's view, the Board had been influenced by attending the settlement discussions and there was a reasonable apprehension of bias.

The second ground for review was that the Board made an error in finding it had unlimited discretion to deny an application. In order to qualify for payment under s. 39 three things had to be proved: that there was a lease in existence, that there was money due under the lease and that money had not been paid for over thirty days. The Court held that as long as these three conditions were met, the Board had no discretion and, therefore, in this case the Board was obligated to award payment to Todd. The Court rejected the Board's argument that it required discretion to deal with cases; for example, where a landowner prevents a lessee from entering the land. In such a case the Court stated that no money would be owing on the lease and therefore the three conditions would not be met. The Board also argued that, as lay persons, the Board could not decide legal questions, namely whether the lease was valid in this case. The Court pointed to several administrative tribunals that decide issues of law and rejected the Board's argument.

The third and fourth grounds for review put forth by Todd were that the decision was unreasonable and was based on irrelevant considerations. The Court held that the Board's reliance on Todd's refusal of the settlement offer fell under both of those grounds.

The result was that the Board's decision was quashed. Todd's application under s. 38 was remitted back to the Board, which was directed to grant the application unless it found there was no lease in existence. The status of the Board's decision is not yet known.

C. *WESTCOAST ENERGY INC.* v. *HUSKY OIL OPERATIONS LTD.*[168]

This is an appeal from a decision of the Public Utilities Board. The issues under appeal primarily relate to an accounting between Westcoast Energy Inc. ("Westcoast") and Husky Oil Operations Ltd. ("Husky") arising from the sale by Westcoast of sulphur by-product obtained from the processing of Husky's natural gas. The structure of the

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166 *Supra* note 164.

167 (1992), 89 D.L.R. (4th) 289.

168 (1995), 165 A.R. 143 (C.A.).

arrangement was that Westcoast would purchase natural gas from Husky and then would refine, process and market such natural gas. Pursuant to this contract, Husky was to receive a border price from the sale of its gas, less the cost of service for processing and transporting such gas. Initially, the sulphur by-product was considered a waste product. However, a market for the sulphur was eventually found and Husky claimed to have an interest in the revenue associated with the sulphur.

Originally, sulphur revenues received by Westcoast were treated by the Alberta Petroleum Marketing Commission ("APMC") as a deduction from Husky's Alberta Cost of Service ("ACOS") for a portion of the period in which sulphur was marketed. Notwithstanding this deduction, all revenue received from the sale of sulphur was retained by Westcoast. Subsequently, the APMC redetermined the Husky ACOS and deleted the sulphur revenue credit for this initial period and for an additional twenty-three month period. Husky objected to these determinations by the APMC and launched an appeal to the Public Utilities Board. The Public Utilities Board allowed the appeal and ordered the matter be returned to the APMC so that the ACOS could be recalculated by crediting revenues received by Westcoast in respect of the sulphur revenue. Husky also claimed interest in respect of such revenue credits but the Board refused to make an order as to interest since it did not have sufficient evidence to determine the amount of interest that might be due. Westcoast appealed the decision of the Public Utilities Board to the Court of Appeal which upheld the Board's decision.

In accordance with the Public Utilities Board decision, the APMC recalculated the ACOS for the twenty-three months in question and provided for a sulphur revenue credit to Husky, but did not include a consideration of interest. Both Westcoast and Husky objected to the APMC's determination. Westcoast disputed the sulphur revenue calculation and Husky argued that interest should be awarded in respect of the sulphur revenue credit. The APMC reviewed such objections and decided to deny Westcoast's objection, but granted Husky's request for interest. Westcoast then appealed the APMC's decision to the Public Utilities Board, which reduced the ACOS and credit by approximately $4 million. Both Westcoast and Husky appealed the Board's decision on the following questions of law or jurisdiction:

(1) Westcoast asked:

(a) Did the Public Utilities Board, in determining the sulphur revenue credits to the ACOS determinations, err as to law or jurisdiction in its decision in the calculation of, in the matters taken into consideration in determining, or in the manner in which it determined, such credits?

(b) Did the Public Utilities Board err in law or in jurisdiction in making an award of interest on the sulphur revenue credits to the ACOS for the twenty-three month period?

(2) Husky asked whether the Public Utilities Board in its decision erred in law or in jurisdiction in disallowing the sulphur revenue credit, and interest thereon, which related to a sulphur inventory imbalance.

The Court of Appeal dismissed Westcoast's appeal and allowed Husky's appeal.

On the first issue, the Court of Appeal noted that the Public Utilities Board, in issuing its decision, was exercising its special review powers under the *Natural Gas Pricing Agreement Act*[169] and the *Natural Gas Pricing Administration Act*,[170] with respect to its review of the decision of the APMC. The Court of Appeal went on to state:

> The short answer to the Westcoast complaint is that the Commission, by Part 1 of the *Act* is to set the "Alberta Cost of Services", which is to include a calculation of the "cost and charges" of Westcoast for the process of preparing the gas for export, which includes some refinement of it and its transportation to the border. The scheme effectively guarantees remuneration payment to Westcoast (when gas is bought) by an agency of Government for its effort, but only a fair return. In fairness, it should account, as a rebate against costs, what it is able to recover from the process. The value of sulphur is effectively a recovered cost, a saving achieved from the salvage of waste from the process. No question of a "negative cost" [as alleged by Westcoast] arises because the value of the sulphur does not exceed the total cost of refining and removal.
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> ...
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> We think that the calculation of total cost, which is what the *Act* deals with, includes calculation of recovered cost if not also incidental revenue. We think that any other view would not respect the object of the *Act*, which is, for Westcoast, to assure it a fair price, but only a fair price, for the refinement and transportation of the gas.[171]

The Court of Appeal stated it could find no error by the Public Utilities Board in its ruling. The Court of Appeal also stated that neither the APMC nor the Public Utilities Board were required to ascertain in what months sulphur had been produced since Westcoast's practice was to ignore crediting any sulphur revenue until such revenue was actually received from the purchaser of such sulphur. As a result, the Court of Appeal found it virtually impossible to relate sulphur revenues to any particular month.

The Court of Appeal discussed the very broad powers given to the APMC in determining the ACOS of natural gas pursuant to the provisions of the *Natural Gas Pricing Agreement Act* and stated the APMC did not exceed the authority granted to it by the *Act*, nor did the Public Utilities Board err in affirming the APMC's determination.

With respect to the second issue, Westcoast argued that the Public Utilities Board erred in awarding interest to Husky in the absence of express statutory authority, particularly since Husky was denied interest in earlier proceedings before the Public Utilities Board and the Court of Appeal. Alternatively, Westcoast argued that *res*

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169 R.S.A. 1980, c. N-4.
170 R.S.A. 1980, c. N-3.
171 *Supra* note 168 at 147-48.

judicata effectively barred any claim by Husky for interest after it had been denied interest earlier by the Public Utilities Board and the Court of Appeal.

The Court of Appeal referred to s. 56 of the *Public Utilities Board Act*,[172] which allows the Board to re-hear an application or to rescind or vary any order or decision made by it. The Court of Appeal stated that strict guidelines must be followed when determining whether the Public Utilities Board may review prior decisions and therefore a "modified" principle of *res judicata* applied to such deliberations.

The Court of Appeal, when referring to the Public Utilities Board decision, noted that the Board merely declined to exercise jurisdiction to award interest rather than making a conclusive determination. Further, given the broad powers granted to the Public Utilities Board, the Court of Appeal could find no finality to the Public Utilities Board's earlier refusal of an award of interest which would invoke the doctrine of *res judicata*. With respect to the authority of the APMC or the Public Utilities Board to make an award of interest, the Court of Appeal referred to the decision of the Public Utilities Board, stating that the statutes do not conclusively set forth all the matters which are to be determinative of the ACOS and interest is an appropriate matter to be considered in debiting or crediting the ACOS where such interest pertains to monies improperly withheld. Therefore, the Court of Appeal held the Public Utilities Board had jurisdiction to allow interest in such circumstances.

With respect to the third issue, the inventory imbalance, it related to a situation existing between Westcoast and the purchaser of gas. The Court of Appeal was of the opinion that such inventory imbalance, which was settled in Westcoast's favour, should be credited to the ACOS of Husky and would not be a "windfall" to Husky. The Court stressed that all Westcoast was entitled to was a fair price for the processing of Husky's gas, and that Husky was entitled to the benefit of the sulphur credits associated with such inventory imbalance.

D. *CANADIAN WESTERN NATURAL GAS CO.* v. *ALBERTA ENERGY CO.*[173]

This case displays the importance of ensuring that terms of reference for an arbitration are included in the original agreement or in any arbitration agreement entered into prior to the arbitration commencing.

Canadian Western Natural Gas Co. ("CWNG") and Alberta Energy Co. ("AEC") were parties to a twenty-year term gas purchase contract dated October 1, 1976, pursuant to which CWNG purchased gas from AEC. The agreement provided that should the parties be unable to agree upon a price to be paid for the gas supplied during a particular contract year (ending October 31), the price was to be redetermined by arbitration pursuant to the provisions of article XVI of the agreement.

172 R.S.A. 1980, c. P-37.
173 [1995] A.J. No. 310 (Q.B.) (QL).

The parties were unable to agree upon on the price to be paid under the gas purchase contact for two contract years from November 1, 1988, to October 31, 1990. To resolve the dispute, the parties entered into an arbitration agreement dated June 11, 1993, which provided for arbitration in accordance with the relevant provisions of the gas purchase contract and those of the Alberta *Arbitration Act*.[174] However, this arbitration agreement did not vary or make inapplicable the provisions of s. 12 of the *Natural Gas Marketing Act*.[175] As a result, the tribunal's mandate was governed by this section, the provisions of which will not be cited hereunder.

The arbitral tribunal, which consisted of three people, rendered a unanimous decision setting prices for gas supplied under the contract for the two years in question. CWNG applied to the Court pursuant to s. 44 of the *Arbitration Act* for an order granting leave to appeal the award of the arbitral tribunal on alleged questions of law. The application was brought pursuant to s. 44(2) of the *Arbitration Act* since the parties' arbitration agreement did not expressly provide for an appeal.

CWNG alleged that the arbitral tribunal erred in interpreting s. 12 of the *Natural Gas Marketing Act* by holding that s. 12(4) of the *Act* required it to give some weight to extra-Alberta market prices and that it was constrained by this interpretation from considering a market price based solely on comparable intra-Alberta prices. AEC, on the other hand, submitted that the method or approach used by the tribunal to determine a market price was not a question of law alone. Mason J. of the Alberta Court of Queen's Bench denied the application for leave to appeal the arbitral tribunal award.

In his decision, Mason J. stated:

> Generally speaking, the proper construction of a statute will be a question of law. In particular, I find that the interpretation and proper application of section 12 of the *Natural Gas Marketing Act* must perforce be a question of law. By its very provisions, section 12 applies to every arbitration under *Arbitration Act* that is to determine the initial price of gas or to redetermine the price of gas delivered under a gas contract in Alberta unless the parties to the arbitration agree to vary or contract out of its provisions.[176]

Mason J. then stated that the factors outlined in ss. 12(4) and 12(5) of the *Natural Gas Marketing Act* must be taken into account to the extent that evidence is adduced in respect of such factors. However, the arbitral tribunal has full discretion as to how it determines the price of gas, providing it considers such factors when there is evidence adduced concerning them. Specifically, Mason J. stated:

> The arbitral tribunal must understand they are free to reject, *i.e.* to give zero weight, to any evidence in reaching their determination or, to give whatever weight they should decide such evidence merits. This decision is completely within their discretion.[177]

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174 R.S.A. 1980, c. A-43.

175 S.A. 1986, c. N-2.8.

176 *Supra* note 173.

177 *Ibid.*

The Court went on to state that the determination of the value or the price of gas based on the legislated formula approach is a question of fact or at least, one of mixed fact and law. However Mason J. also stated that the tribunal must correctly construe and apply the provisions of s. 12, as that is a true question of law. Mason J. could find no indication that the tribunal erred in its interpretation of the section or that it failed to understand its scope of discretion in applying the formulated approach and the facts relating to redetermination of the price. Further, Mason J. stated:

> Therefore, any error it made, if there be any error, was in the sphere of fact and law, in either the weight it may or may not have given to the evidence adduced, or its actual redetermination of the price on the facts it found from the evidence adduced.[178]

As a result, the leave to appeal was denied.

XII. LEAVE TO APPEAL TO THE SUPREME COURT OF CANADA

Other than as previously set forth in this article or outlined below, we are not aware of leave to appeal being sought for any of the decisions set forth in this article or in last year's "Recent Judicial Developments" article.[179] However, the judgment roll for some of the decisions referred to in both articles had not been entered at the time this article was prepared so appeals of some decisions may be forthcoming.

A. *MESA OPERATING LTD.* v. *AMOCO CANADA RESOURCES LTD.*

Leave to appeal to the Supreme Court of Canada was dismissed with costs on October 6, 1994.[180]

B. *EASTMAIN BAND* v. *CANADA (FEDERAL ADMINISTRATOR)*

Appeal to the Supreme Court of Canada was dismissed with costs.[181]

C. *PAN OCEAN OIL LTD.* v. *CANADA*

Leave to appeal to the Supreme Court of Canada was dismissed with costs on November 17, 1994.[182]

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178 *Ibid.*

179 *Supra* note 102.

180 [1994] S.C.C.A. No. 202 (QL).

181 [1993] S.C.C.A. No. 23 (QL).

182 [1994] S.C.C.A. No. 360 (QL).