RECENT JUDICIAL DEVELOPMENTS OF INTEREST TO OIL AND GAS LAWYERS

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The purpose of this paper is to provide a brief review of recent Canadian judicial decisions rendered to June 1991 and of interest particularly to oil and gas lawyers. The authors have surveyed Canadian case law in the areas of the environment, surface rights, contract, government regulation, land titles, tax, freehold leases and creditor's rights.

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I. INTRODUCTION

The purpose of this paper is to provide a brief review of recent Canadian judicial decisions rendered to June 1991, and of interest to oil and gas lawyers. In order to place some reasonable limit on the scope of this paper, we have attempted to focus on decisions which we considered to be of particular significance to the oil and gas industry and of interest to oil and gas lawyers generally. We have included or excluded decisions accordingly. In many instances we have also limited our discussion of decisions to those

issues therein which we considered to be of particular significance to the oil and gas industry and of interest to oil and gas lawyers generally.

We have grouped the decisions into categories for referential purposes, however, the reader should appreciate that in certain instances such categorization was made difficult as a result of the issues being raised pertaining to one or more of the identified categories. In these instances we have categorized the decision in accordance with the issue which we felt was dominant.

Finally, where we have made reference to or quoted from unreported decisions we caution the reader that these reports are unedited and may therefore contain errors.

II. ENVIRONMENTAL REGULATION

A. *Director of Pollution Control* v. *Bavarian Lion Company*[1]

In this case, the Alberta Court of Appeal upheld a chemical control order issued under s. 6 of the *Hazardous Chemicals Act*.[2] The order required the respondent to remove polychlorinated biphenyl-contaminated material from its own premises and deliver it to an approved licensed hazardous waste storage facility. The respondent's defence had been s. 3 of Alberta Regulation 505-87 (passed under the *Hazardous Chemicals Act*), which provides that ss. 7.4(1)(a), (b), (d) and (e) of the *Hazardous Chemicals Act* do not apply to a person who treats, stores or disposes of hazardous waste generated by him on premises occupied by him.

Thus the case deals with a potential conflict between two Alberta legislative provisions and addresses the manner in which to interpret the exemption contained in the regulation. Bearing upon the decision is a conflict between environmental policy concerns and private ownership rights. In this decision, an individual's property rights (if the exemption in Alberta Regulation 505-87 can be called a property right) were lost to the need for environmental protection. The decision brings to mind the *Northern Badger* decision in the Court of Queen's Bench,[3] in which legislative provisions were interpreted in such a way that individual property rights (in the form of a secured creditor's rights) prevailed over environmental protection (albeit in more difficult circumstances, from the environmentalist's point of view).

The Court here decided that s. 6 of the *Hazardous Chemicals Act* gives the Director of Pollution Control the power to direct either onsite or offsite storage. It was the view of the Court that a narrower reading would leave the result that if:

> ...there is no adequate and safe method of storage of hazardous wastes onsite, the Director is powerless and the safety of persons continues to be impaired. In our view, to place such a limitation on the powers of the Director under Section 6 would be to prohibit the Director from acting when one of the dangerous

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1. [1990] 76 Alta. L.R. (2d) (394) (Alta. C.A.).
2. R.S.A. 1980 c. H-3.
3. *Infra*, note 46.

situations described in Section 6(1)(a) to (e) exists. We see no such limitation in the powers of the Director under Section 6 of the Act. A safe and proper manner of storage can be onsite or if need be it can be offsite. Of necessity this means that the hazardous waste has to be transported. However, that is necessarily incidental to the order which directed the manner of storing the waste.

It is true that this operates as a limitation of the rights of storage given to an individual under Section 3 of the regulations. However it is a restriction which is not only desirable but necessary when one of the dangers enumerated in Section 6(1)(a) to (e) exists.

The relevant provisions of s. 6 read as follows:

6(1) When, in the opinion of the Director, the use, handling, storage... or method ... of transportation of a hazardous chemical...

(c) adversely affects or is likely to adversely affect the health or safety of any person...

the Director may, whether or not the chemical, substance or thing is named in the Schedule, make an order called a "chemical control order" directed to the person responsible for the hazardous chemical...

(2) The Director, in a chemical control order, may order the person responsible... to...:

(c) comply with any directions set out in the order relating to the manner in which a hazardous chemical... may be handled, stored, used, disposed of, transported, displayed or manufactured.

In this decision, the Alberta Court of Appeal gave a broad interpretation to a legislative provision and a narrow interpretation to an exemption, with the objective of granting power over an environmental situation to an administrative tribunal. The Court justified its interpretation on the basis of public policy. The technical difficulty caused by Alberta Regulation 505-87 (and, arguably, the private property right involved there, although that perspective does not appear in the decision) was overcome, since it was "desirable" and "necessary" to protect against environmental dangers.

The arguments in *Northern Badger* were such that the contest was framed as one between the public purse and the receiver of the responsible party. One has to wonder whether it would have made a difference in *Northern Badger* if the Board had argued that it was "necessary and desirable" to restrict the property rights given to the secured creditor of *Northern Badger* under the *Bankruptcy Act* in order to protect against an environmental danger. No doubt, the *Northern Badger* decision is distinguishable on the basis that the "property right" involved there (the first priority position of a secured creditor) was granted under a federal statute (the *Bankruptcy Act*), whereas the one involved in this case was granted under a provincial regulation, however, it is interesting to note the different weight given to public policy in this decision.

B. *R. v. OMI International (Canada) Inc.*[4]

As is so often the case when federal jurisdiction over environmental matters is challenged, the challenge in this particular instance was successful.[5] In this case the challenge was successful because the Ontario Provincial Court made a "functional, practical judgment" (the Court's words) about the factual character of the defendants' ongoing undertakings (as required by *Northern Telecom* v. *C.W.C.*[6]) and found that, in pith and substance, they were not of the nature regulated by the federal legislation.

OMI International (Canada) Inc. ("OMI") was incorporated in Ontario and manufactured and distributed electro-plating chemicals and solutions. Its business premises were located within Ontario and its products were transported by trucks owned and operated by independent contractors carrying on as common carriers. The other defendant, Johnson Matthey Limited ("Johnson"), was a federally incorporated company whose business was conducted equally within Ontario and elsewhere with its products and supplies being transported by truck and plane by a common carrier. Both companies were charged under the federal *Transportation of Dangerous Goods Act*[7] with improperly handling and transporting dangerous goods when a truck owned by Johnson picked up solution from OMI's premises and transported it to Johnson's refinery for processing. The defendants were successful in having the information quashed on constitutional grounds, once they convinced the Court that the defendant OMI was primarily a manufacturer of hazardous chemicals and solutions and the defendant Johnson was primarily a refiner.

As Johnson was primarily a refiner, distribution was necessarily incidental to its primary business and it followed that distribution was not the purpose or object of its undertaking. On the facts, both OMI and Johnson shipped only by means of independent contractors who were common carriers. Therefore, neither was carrying on a "motor vehicle" undertaking as defined by the *National Transportation Act.*[8]

In "deference to the very thorough and able arguments which were submitted" on behalf of the federal government, the Court reviewed the Crown's arguments in some detail. Lagdon Prov. J. noted at page 199 that:

> I did not see any reason why cooperative legislation from the provinces relating to local undertakings and inter-provincial transportation cannot be combined with appropriate federal legislation to address the obvious concern over hazardous substances.

He added that the federal statute contemplated such cooperative legislation and then concludes that:

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4. (1989), 4 C.E.L.R. (N.S.) 190 (Ont. Prov. Ct. Criminal Division).
5. Mr. Justice LaForest of the Supreme Court of Canada discussed this issue very eloquently at a presentation made to the University of Calgary Law School on January 15, 1991.
6. (1979), 98 D.L.R. (3d) 1 at 18 (S.C.C.).
7. S.C. (1980-81-82-83), c. 36 (now R.S.C. 1985, c. T-19), ss. 9, 10, 11 and 32.
8. R.S.C. 1970, c. N-17 (now R.S.C. 1985, c. N-20) (ss. 2 and 4).

> ...such a cooperative federalism being built into the Act is entirely inconsistent with Parliament's attempting to usurp exclusive jurisdiction over the transportation of dangerous goods as an area of national concern under the Peace, Order and Good Government head of federal jurisdiction.

C. *R.* v. *Northwest Territories Power Corporation*[9]

In this case, the defendant was charged with and pleaded guilty to the offence of permitting the deposit of a deleterious substance into waters frequented by fish, contrary to s. 36(3) of the *Fisheries Act.*[10] The Court then considered the matter of sentence, reviewing the mitigating factors to be considered in imposing sentences for environmental offences. Another important aspect of this decision is the Court's search for a way to impose a sentence which would reach the directors which it saw as bearing personal culpability. Although the Court did not explore its ability to impose personal fines (for which, of course, the company could reimburse the directors in any event), the Court ordered a public apology by the directors and the chief executive officer. The Court was seeking to achieve a deterrent effect in providing the public with the identity of those who had "presided over the degradation of the public domain." The decision also raises an interesting issue, that being whether an environmental fine imposed against a utility will simply be passed on to the ratepayers.

1. Mitigating Factors

The Court reviewed the mitigating factors to be considered in imposing sentences for environmental offences. The Court concluded that it was not a mitigating factor that the defendant's predecessor corporation had allowed the site to deteriorate and had failed to train local staff in spill response. The defendant had acquired physical assets under an agreement which provided that the assets were purchased "as they existed" in the context of a purchase of a going concern. It does appear that the predecessor's difficulties with oil spills may have been set out in the acquisition agreement by way of a "Waste Management Report." The defendant argued that it was "taken by surprise" and was "unprepared to deal with the events because of the inexperience of headquarters staff," the defendant's lack of attention extended to using only a "taste test" for water being disposed from a fuel tank.

The Court held that the purchase and sale was a sophisticated one, negotiated by "the best minds available with full disclosure and with open eyes." Bourassa J. appears to impose the rule of law as he states at page 60 that:

> The law represents a continuing standard, a duty of care that conduct is to be measured against regardless of the offender or its antecedents. To accept the "naivety" or "innocence" (in a non-legal sense) of the offender as a mitigating factor would amount to a licence to transfer or restructure businesses when liability has reached the point of no return, inducing the belief that the full force of the law will be suspended pending some maturing process. For a multi-million dollar operation, in my view, this position

[9] (1990), 5 C.E.L.R. (N.S.) 57 (N.W.T. Terr. Ct.).

[10] R.S.C. 1985, c. F-14.

> is grossly untenable. Society cannot afford to nurse major multi-million dollar undertakings along while they discover and learn to respond to their legal duties. We cannot, in my view, lower the standards, which is in effect what the defendant is seeking.

The Court also refused to accept lack of prior enforcement against the predecessor as a mitigating factor given:

(a) the nature of the offence;

(b) the high profile which environmental matters have achieved in the public eye;

(c) the significant penalties imposed in the past in many jurisdictions; and

(d) that the matter did not turn on a new, novel or untested law or concept.

2. Who Will Pay?

The defendant also argued that it had no money of its own and that any penalty would thus be reflected in its "rate base." The Court seemed frustrated with this reality and although its response was terse, the best that it could do was to add a requirement for a public apology from senior officers. Obviously, the Court had no authority to make a finding on the rate base point, that would fall under the authority of the supervising regulatory body having jurisdiction over such matters (the Northwest Territories Utilities Commission). However, the Court seems to be attempting to influence that authority through the use of stern comments found at page 61:

> That is, of course, tantamount to victimizing the public twice over – pollution of the public domain and making the public pay for that very active pollution. Put in a different way, the defendant expects the public to pay for the defendant's negligence and incompetence. In addition, the defendant then goes on to state that it is not possible to promise that the corporation will not be responsible for future oil spills.
>
> The jurisprudence in this matter is clear and this issue has been tested in numerous cases, and I can only repeat that the penalties imposed should and will exceed the costs of compliance. Only through compliance with the law, and the duties it imposes, will respect for the law be encouraged and negligence in operations deterred.... To expect and in effect plan for (the public) to pay for negligence and sub-standard compliance, and indeed non-compliance, does not reflect well on the defendant's sense of responsibility.

Although the Court recognized that society would ultimately have to pay a premium for environmental protection, the costs of immediate clean-up and restoration were not to be viewed in that light. The Court would not condone "the cost of doing business" mentality in that context. Bourassa J. noted that he was left with a sense of unease in that he had the distinct impression that "this matter is but an annoying irritating obligation rather than an important continuing responsibility." He noted that corporate defendants generally and public corporations in particular, present a challenge in sentencing in that they have "no body to kick, no soul to damn" and here, no money of their own to take.

3. The Corporate Veil and Director Liability

After imposing a fine of $15,000 the Court sought a more appropriate way to address the corporation's irresponsible attitudes. The decision contains some very interesting observations at page 65 pertaining to the responsibilities of directors (particularly in the fifth paragraph quoted below):

> The chief executive officer and the board of directors... are... the people who have accepted the responsibility of overseeing and directing the corporation's management.
>
> Unfortunately... humans in a corporate framework sometimes develop a reduced sense of responsibility for acts that occur when they are brought together in large institutional frameworks.... Responsibility is passed up one side of the pyramid, and back down the other side.
>
> To view the corporate defendant as simply a person with money may achieve very little in terms of sentencing goals as the law reform commission has stated in Working Paper 16, Criminal Responsibility for Group Action (Law Reform Commission of Canada) – "we must attempt to develop and use innovative methods of sanctioning groups... heavy fines are not the answer."
>
> One such method may be to reach through the corporate veil, well past the defendant's pockets, and to touch the heart and mind of the defendant – the directors....
>
> Indeed, in accepting a position on a board of directors, they must address their responsibility for the policies, priorities and values inherent in the corporation's operations. The public is never made aware of who these people are who, rhetorically speaking, love their children, go to church on Sunday, and preside over the degradation of the public domain on Monday.

Section 41(2) of the *Fisheries Act* enabled the Court to impose any punishment which "will or is likely to prevent the commission of a further offence." Under that wording, the Court seized authority to order the directors and chief executive officer to apologize to the public for their negligence, Bourassa J. noting that this was "appropriate," "permissible in law" and "reasonable and rationally linked to the objective of the stated sentencing goals." Further, it was not without precedent. Bourassa J. even wrote the form that the apology was to take and attached it to his judgment.

The current draft of Alberta's proposed *Environmental Protection and Enhancement Act* provides that directors and officers have a "due diligence" duty to "take all reasonable care." The Environmental Legislation Review Panel has proposed in its January 11, 1991 report that the relevant section go on to impose personal liability on directors who are guilty of wilful wrongdoing or gross negligence.

D. *R.* v. *Imperial Oil Ltd.*[11]

In this case, the corporate defendant was charged with and pleaded guilty to unlawfully operating a storage tank facility in a manner contrary to s. 7 of the *Clean Environment Act* [12] after a substantial spill had occurred at one of its petroleum bulk plants. In argument to sentencing, the defence submitted that there had been a technical breach of the Act only, caused by a confusion about the meaning of the applicable regulation and that the defendant was misled as to the law by the policy of the provincial Department of the Environment. As such, the defence pleaded officially induced error at law in mitigation of sentence. On the facts present, it was held by the Court that this defence could not be pleaded to mitigate the sentence. The Court concluded that "the principles of sentencing that should be given paramountcy in this case are the principles dealing with deterrence and protection of the public." As to "officially induced error of law," the Court stated at page 105 that:

> ...although ignorance of the law is not an excuse, it may be a mitigating factor in sentencing if the accused's mistake was honest and reasonable.... The defence is available if the accused reasonably believed in a mistaken set of facts which if true would render the act or omission innocent, or if he took all reasonable steps to avoid the particular event. In the appropriate case, this defence might be considered by a Court in mitigation of sentence.
>
> The Supreme Court of Canada has recognized in *R.* v. *MacDougall*, [1982] 2 S.C.R. 605 . . . that in certain cases a defence of officially induced error of law may lie.

A decision of the Ontario Court of Appeal in *R.* v. *Cancoil Thermal Corp.*[13] was quoted at page 106:

> The defence of "officially induced error" is available as the defence to an alleged violation of a regulatory statute where an accused has reasonably relied upon the erroneous legal opinion or advice of an official who is responsible for the administration or enforcement of the particular law.... The reasonableness will depend upon several factors, including the efforts he made to ascertain the proper law, the complexity or obscurity of the law, the position of the official who gave the advice, and the clarity, definitiveness and reasonableness of the advice given.

On the facts of this case, however, the Court held that erroneous advice from an official had not led to the conclusion that a particular report did not have to be filed. Further, the Court observes at page 108:

> The most compelling reason for not giving effect to the defence argument is the fact that Imperial Oil never sought any advice from the Department.... No advice from an official was sought by the accused and no erroneous advice was ever given.

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11. (1988), 4 C.E.L.R. (N.S.) 98 (Man. Prov. Ct.).
12. S.M. 1972, c. 76.
13. (1986), 52 C.R. (3d) 188.

As to the size of the fine that should be imposed as an incentive to comply with regulations which cannot be strictly enforced, the Court suggested that it should be mindful of:

(a) the types of offences committed;

(b) the capacity of the accused to pay; and

(c) that the fine not be perceived to be a licensing fee to continue the noncompliance.

The Court was cognizant of the fact that corporations are to be treated differently than individuals under s. 7 of the *Clean Environment Act* which "provides for a maximum fine for a corporation, ten times that for an individual" and a fine of $5,280 was imposed.

E. *Shamrock Chemicals Ltd. et al* v. *R.*[14]

Again, the issue in this case was sentencing for an environmental offence. The most interesting issue raised was whether penalizing both the company and an individual, being the directing mind of the company, was in effect penalizing the same person twice. The Court held that it was not, and allowed both to be fined. McDermid D.C.J. stated at page 320:

> If Mr. Shirley had decided to operate this business as a sole proprietorship, obviously he is the only person who could have been convicted and punished. However, he chose to conduct his business through the instrumentality of a corporation, thereby creating a separate legal person. No doubt he did so for reasons that were advantageous to him from an operational point of view. However, there are certain burdens as well as benefits which result from the incorporation of a business.
>
> I see nothing wrong in penalizing both the individual and the corporation in circumstances such as those that presented themselves... in this matter.

The appellant also argued that s. 11(i) of the *Canadian Charter of Rights and Freedoms*[15] should apply to prevent it from being exposed to the greater punishment that would flow from the application of a section that had been added to the *Environmental Protection Act*[16] well after the date of the offence in question. Section 11(i) of the Charter provides that if the punishment for an offence has been varied between the time of commission and the time of sentencing, a person is entitled to the benefit of the lesser punishment. The Crown had countered that the offence was a "continuing one," such that the appellant should be subject to the increased penalties available on "a subsequent conviction." On the facts, there had been no "prior conviction" and the appellant's argument prevailed.

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14. (1989), 4 C.E.L.R. (N.S.) 315 (Ont. Dist. Ct.).
15. Part I of the *Constitution Act, 1982*, being Schedule B of the *Canada Act, 1982* (U.K.), 1982, c. 11 [hereinafter the "*Charter*"].
16. R.S.O. 1980, c. 141.

F. *Regina* v. *Imperial Oil Ltd. and Andre Laferriere Fuels Ltd.*[17]

The issue in this case was whether an environmental spill of gasoline constituted one offence or several for the purposes of sentencing. The gasoline in question had found its way into a city sewer system, causing explosions and fires in residences, the evacuation of houses and businesses, discontinuance of electrical and gas services, interference with businesses and physical discomfort. Each count in the Information related to a specific consequence or victim of the spill and the appellants were convicted on all twenty-seven counts.

The appellants successfully convinced the Ontario Court of Appeal that the wording of s. 13(1) of the *Ontario Water Resources Act*[18] created one generic offence only, such that the convictions should be quashed on all counts except count number one. The Court seems to come to this conclusion quite reluctantly. Although Brooke J.A. agrees that "it should be" that a person be held accountable for the harm done to each victim of the discharge of a contaminant into the natural environment for which he is responsible, Brooke J.A. concluded that consistent with the scheme of the Act (i.e., to make the owner or person having control of the contaminant responsible to the community, at his own costs, to clean up the spill and restore the environment, responsible to individuals to compensate each of them for their loss or damage and finally to face prosecution for the prohibited act), s. 13 created a generic offence and precluded separate convictions where adverse consequences affected different victims. As a result, only one fine was imposed.

G. *Honey Bee Sanitation Inc.* v. *Camion Equipment & Leasing Inc. et al*[19]

This appears to have been the first occasion in which a Court had to deal with an assertion that the Crown should be liable to pay an invoice rendered to a person that had been ordered by the Crown to clean up a spill. The case report contains an annotation at page 69 by J.G.W. Manzig suggesting that:

> ... one might... have welcomed a consideration of some of the factual issues raised by the construction of the critical sections (of the *Environmental Protection Act*, R.S.O. 1980, c. 141).... While the result of this decision is clearly correct, an opportunity to give some guidance in the interpretation of the relevant sections of Part IX of the E.P.A. has been missed.

On the facts, it was held that the Crown had not retained or hired Honey Bee and should accordingly not be responsible to pay an invoice submitted by Honey Bee to those parties that had been ordered by the Crown to contain a spill and clean up the affected land and premises. The Court concluded that the presence of Crown representatives on the site and the carrying out of their statutory duties did not make the Crown liable for costs of the clean-up.

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17. (1990), 75 O.R. (2d) 28 (Ont. C.A.).
18. R.S.O. 1980, c. 361.
19. (1989), 4 C.E.L.R. (N.S.) 68 (Ont. H.C.).

The applicant had raised the interesting argument of "quantum meruit," which is somewhat compelling because the public is the ultimate beneficiary of the clean-up work and so perhaps the Crown should be liable for the cost of the work. However, on the basis of the statutory provisions involved, the Court determined that the public was not to pay for the clean-up work, that responsibility being solely for the polluter.

H. *Association of Stop Construction of Rafferty Alameda Projects Inc.* v. *Herb J. Swan; the Minister of Environment and Public Safety for the Province of Saskatchewan; Souris Basin Development Authority*[20]

Further to the discussion of the Rafferty dam matter contained in last year's paper,[21] this additional judgment dealt with the following issues:

(a) whether the plaintiff had standing to bring the action;

(b) whether a "justiciable" issue had been raised;

(c) whether the plaintiff's statement of claim constituted an abuse of process;

(d) whether one can commence an action which is a proceeding to obtain declaratory relief and in the same action seek personal relief;

(e) whether a breach of statutory duty could be the basis for a claim in damages; and

(f) whether the responsible Minister could be added as a defendant in his personal capacity.

On the issue of "standing," the Court held at page 247 that the plaintiff had to demonstrate:

> ...a direct, personal interest in the alleged improper granting of the ministerial approval for the dam. Because some of its members who lived in the area of the project had a direct personal interest in the propriety of the approval, the plaintiff had standing.

Also, there was no other reasonable or effective manner in which this issue could have been brought to Court.

It was argued that the plaintiff's statement of claim failed to raise a justiciable issue. However, the Court concluded that as the plaintiff was asking serious questions about the interpretation of the *Environmental Assessment Act*[22], a justiciable issue had been raised. It was also argued that the plaintiff's statement of claim disclosed no reasonable cause of action, was frivolous and vexatious and was an abuse of process. The Court in response

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20. (1989), 3 C.E.L.R. (N.S.) 236 (Sask. Q.B.).
21. See Donald C. Edie, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (1991), 29 Alta. L.R. 191.
22. S.S. 1979-80 c. E-10.1.

concluded that the statement of claim disclosed a reasonable cause of action and as such could not be said to be an abuse of process.

With respect to the issue of whether actions for declaratory and personal relief could be joined, the Court concluded that where the essential thrust of the statement of claim is for a declaration that the impugned ministerial approval is legally invalid, the Court should strike those portions of the claim that attempt to establish a "personal" right of action against the Crown for damages. This was determined to be especially so in this instance where the declarations were being sought as foundations upon which to base a claim for "personal" relief.

Counsel for the Minister argued that a breach of statutory duty could not be the basis for a claim in damages and that the Minister should not have been named in his personal capacity, and the Court agreed. It was held that a breach of a statutory duty could not be redressed by damages unless the statute expressly provides for them. Here, a right to damages could not be implied because the statute provided for an award of damages, but not as against the defendant, against whom they were sought in this case. In addition, damages would only be available where the facts gave rise to a tort beyond the mere breach of statute. Finally, the Court held that there was no basis on which to name the Minister as a defendant in his personal capacity as under the accepted common law practice associated with seeking declaratory relief, if a Minister was to be sued, it had to be in his representative capacity (i.e., the Minister must to be named in that capacity as it is the office and not the individual that is being sued).

I. *R.* v. *Ellis-Don Ltd.*[23]

This case is significant not only in the context of environmental offences, but also in any context in which the common law defence of "due diligence" may apply as here the Ontario Court of Appeal considered this defence and the associated burden of proof. The appellants were convicted of offences under Ontario's *Occupational Health and Safety Act*.[24] They appealed, arguing that the burden of proof upon a person charged with certain offences under the Act (which burden resulted from a provision of the Act and the decision of the Supreme Court of Canada in *R.* v. *Sault Ste. Marie*[25]) violated s. 11(d) of the *Charter*.[26] In *Sault Ste. Marie* the burden was held to be on the accused charged with a strict liability offence to prove that he took all reasonable care. The *Occupational Health and Safety Act* provides that on a prosecution for failure to comply with certain specified sections of the Act, it shall be a defence for the accused to prove that every precaution reasonable in the circumstances was taken.

The appeal was allowed, the Court holding that by placing the onus on an accused to prove a defence on the balance of probabilities, the *Occupational Health and Safety Act* infringed the presumption of innocence enshrined in s. 11(d) of the *Charter* as the onus

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23. (1991), 1 O.R. (3d) 193 (Ont. C.A.).
24. R.S.O. 1980, c. 321.
25. [1978] 2 S.C.R. 1299 [hereinafter "*Sault Ste Marie*"].
26. *Supra*, note 15.

could require a court to convict even though it might have a reasonable doubt about the accused's guilt. The Court noted that there was no essential difference between the expression "every precaution reasonable in the circumstances" in the *Occupational Health and Safety Act* and the expression "all reasonable steps to avoid the particular event" used in *Sault Ste. Marie*. The Court stated that the defence as provided in the *Occupational Health and Safety Act* was a codification of the defence of due diligence recognized in *Sault Ste. Marie* and that the onus of proving the defence imposed by common law as enunciated in *Sault Ste. Marie* also infringed s. 11(d) of the *Charter*.

J. *R.* v. *Blackbird Holdings Ltd.*[27]

In this case, charges were laid against Blackbird Holdings Limited and Mr. George Crowe, the controlling shareholder of Blackbird Holdings alleging, among other matters, that the accused committed the offence of causing or permitting the discharge of waste materials from drums buried on property owned by Blackbird Holdings. The accused were ultimately found guilty as the evidence showed that Mr. Crowe was taking waste materials from various sources and burying such materials on his land. The Ministry of the Environment investigators uncovered 185 gallon drums of waste.

What is noteworthy about this case is that Mr. Crowe was sentenced to six months in jail, this being the first time an individual has been imprisoned for an environmental offence. As noted by Stella Cuban in an article entitled "MOE Flexes Legal Muscle":

> For many years corporate officers and directors were insulated from prosecution for environmental offences that their companies committed. This was usually a result of an elaborate hierarchy of responsibility that insulated the officers and directors from any direct knowledge of the shortcomings of the company's environmental program.
>
> In 1986, Ontario introduced amendments to its environmental legislation to provide that every director and officer has a duty to take all reasonable care to prevent the corporation from causing or permitting an unlawful discharge, that every person who fails to carry out that duty is guilty of an offence; and that directors and officers of a corporation are liable for convictions whether or not the corporation has been prosecuted or convicted. This case suggests that the courts are beginning to recognise the duty of company officials to prevent unlawful discharge and makes significant in-roads for corporate officer and director liability.[28]

27. [1990] O.J. No. 1325.

28. Newsletter of the Canadian Environmental Law Association, Volume 15, Issue 4, July/August 1990 at 2.

III. CREDITORS' RIGHTS

A. *Hamilton Bros. Corp.* v. *Royal Trust Corp. of Canada*[29]

In this case Mason J. considered the nature of petroleum and natural gas rights, for the purpose of determining whether such interests were exigible under the *Seizures Act*[30] under either s. 15 (as "land") or under s. 5 (as a "chattel real" or "leasehold"). The case demonstrates that the legal characterization of these interests, which often seems nebulous and even meaningless, can sometimes have a very real, practical significance. Different procedures and consequences apply under each of s. 5 and 15.

It may surprise some that the Court determined that, at least for purposes of the *Seizures Act*, working interests in oil and gas leases are not "land" but are, rather, "chattels real." The one single overriding royalty was not specifically analyzed.

Hamilton Brothers Corporation ("Hamilton") was a judgment creditor of Jennifer Petroleums Ltd. ("Jennifer") under two separate judgments totalling in excess of $11,000,000, had writs of execution filed and had the sheriff seize the "Jennifer Interests." The Jennifer Interests were small beneficial working interests in a certain zone underlying seventy-nine petroleum and natural gas leases in Alberta and an interest in one gross overriding royalty in Alberta. The Jennifer Interests were subject to two separate grants of security under s. 177 of the *Bank Act*, one to Barclays Bank of Canada and the other to the Bank of Montreal. Hamilton sought an order for sale of the Jennifer Interests either as:

(1) interests in land under s. 15 of the *Seizures Act*; or

(2) chattels real or leasehold interests under s. 5 of the *Seizures Act*.

A further alternative was for equitable execution under Rules 383(2) and (3) of the Alberta Rules of Court, applying to interests in land which cannot otherwise be sold under legal process.

Both Jennifer and Barclays Bank of Canada opposed the application on the basis that the Jennifer Interests were not exigible and not subject to seizure and sale. Their position is set out on page 43 as follows:

> Barclays' position, in which it is joined by Jennifer, is set out in a counter-motion filed by Barclays in which it seeks the following declarations from the Court:
>
> a) That the "Jennifer interests" (so defined by the Applicants) are not exigible pursuant to the provisions of the *Seizures Act*;

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29. [1991] 70 Alta. L.R. (2d) 37 (Alta. Q.B.) Notice of Appeal has been filed.
30. R.S.A. 1980 c. S-11.

> b) That if exigible under the *Seizures Act*, they are exigible pursuant to Section 15 dealing with execution against land and the Applicants' motion is not properly before the Court because they have not complied with the provisions of Section 15;
>
> c) But if the "Jennifer interests" are exigible under the *Seizures Act* they consist of equitable interests in working interests in Crown Petroleum and Natural Gas Leases which cannot be sold pursuant to the Writs of Execution;
>
> d) By reason of the prior security granted pursuant to Section 177 of the *Bank Act* to Barclays and the Bank of Montreal, there is no legal or equitable interest to which the Applicants's Writ of Execution can attach so that an Order for removal and sale should not be granted or, alternatively, by reason of the Section 177 assignments, Barclays has a priority over the Applicants' motion;
>
> e) That the Applicants are estopped from applying to have the "Jennifer interests" sold by virtue of the contractual arrangements which govern these interests and to which the Applicants and/or their associates are parties or, alternatively, by virtue of their prior representations and conduct which were relied upon by Barclays at the time they obtained their security over the "Jennifer interests;"
>
> f) That this Honourable Court should exercise its jurisdiction and discretion to deny the Applicants' motion for sale of the "Jennifer interests;" and, finally,
>
> g) If the "Jennifer interests" can be sold they must be sold subject to all charges, liens and equities to which they are subject and that a prospective purchaser cannot stand in any better position that Jennifer with respect to the "Jennifer interests."

The reasons of Mason J. provide at page 40:

> The characterization of the "Jennifer interests" will determine the extent to which extra judicial process can be realized against these interests and the related powers of the Court.
>
> Just what are the beneficial interests of Jennifer in the percentage working interests of the 79 producing oil and gas leases and one gross overriding royalty for which the Applicants seek an order for sale? They are "the remaining or residual interests" (so styled by the Applicants) retained by Jennifer after its corporate predecessor 212634 Oil & Gas Ltd. (one of the Tencos) granted Section 177 securities to the Bank of Montreal and Barclays Bank as security for loans advanced. In essence, they are the beneficial equities of redemption plus the right to qualify for and receive Alberta Royalty Tax Credits and other indefinable interests which could be available to certain bona fide purchasers for value in the marketplace.

Ultimately, the Court concluded that the Jennifer Interests were chattels real, exigible under s. 5 of the *Seizures Act* and exigible and subject to sale pursuant to the writs of execution. However, because of the prior security granted pursuant to s. 177 of the *Bank Act* and because any such sale would have to be subject to the rights of the banks pursuant thereto, no such sale should be ordered because the value of the lands was less than the amounts owed to the banks and secured by the s. 177 security. As Barclays Bank of Canada also held an assignment of rights to receive Alberta royalty tax credits, the Court was also reluctant to order a sale of the equity of redemption because such a sale would place that assignment in jeopardy. Accordingly, the Court appears to have

exercised its discretion to deny the motion, as set out in paragraph (f) of Barclays position.

It is interesting that the Court's refusal to order the sale was based on the question of the value of the equity remaining and that no accounting seems to have been made for future increased values that might result from any number of factors. Presumably, however, the writs of execution will remain in place and if at some point the values would so justify, Hamilton could make the application again. The reasons for decision do not set out the manner of valuation which was accepted by the Court, they state only that "on the evidence before me the value of the 'Jennifer interests' free and clear of s. 177 security is estimated at $2,100,000.00. The s. 177 indebtedness to the banks is estimated at approximately $3,500,000.00."

The decision describes the basic rules by which our litigator friends should execute against petroleum and natural gas rights, setting out the procedure under Rule 347 of the Alberta Rules of Court and s. 5 of the *Seizures Act*. The reasons specifically state that the equity of redemption in chattels real is exigible under s. 5(1) of the *Seizures Act*. As can be seen, the case therefore involves an analysis of the concepts of "interests in land," "chattels real," s. 177 security and the nature of the estate remaining after a grant of such security.

The reasons contain a useful summary analysis of the legal classifications of all property as either realty, chattels real or chattels personal. The analysis and decision of Mason J. on the issue of the nature of oil and gas working interests is set out on page 45:

1. ...just what kind of property is the right to earn, win and take petroleum and natural gas, and what kind of property is an earned working interest in such a right?

2. There are three classifications of property at law (1) realty, (2) chattels real and (3) pure personalty, or chattels personal. See Megarry and Wade: The Law of Real Property, 4th Ed., pp. 10-12.

3. Megarry and Wade at page 11 discuss the fact that leaseholds are still personalty at law although recognized as interests in land and not merely contractual rights, so they have been classed under the paradoxical heading of 'chattels real', the first word 'chattels' denoting their personal nature and the second denoting their connection with land.

4. In Halsbury's Laws of England, 4th Ed., Vol. 39, at p. 213, the author outlines the relationship between real property, chattels real and chattels personal in these terms:

   s. 301 'Real' denotes that the thing itself, or a particular right in the thing, may be specifically recovered; and, since originally specific recovery was only allowed in cases where the claimant was entitled to a freehold interest, that is, an estate for life or a greater estate, 'real property' denotes (1) land and things attached to land so as to become part of it, and (2) rights in the land which endure for a life or were before the passage of the Law of Property Act 1925 inheritable, whether these involve full ownership or only some partial enjoyment of the land or the profits. On the other hand, rights in land which

> endured for a term of years only were not originally specifically recoverable and were described as 'chattels real'.
>
> s. 303 Personal estate is divided into chattels real and chattels personal. Terms of years are chattels real: chattels because they devolve at common law, with chattels in the proper sense, on the personal representatives; real because they are derived out of real estate.
>
> The chief differences between real estate and chattels real were with regard to legal remedies, the mode of devolution on death and the rights of succession in intestacy.
>
> 5. Reference can also be made to Jowitt, Dictionary of English Law, 5th Ed., Vol. 4, p. 358, which defines 'chattels real' as:
>
> ...estates or interests in or arising out of lands. The difference between real estate or freeholds and chattels real consist for the most part in the fixity or non-fixity of their duration. It is the latter property, viz., uncertainty of duration, that characterizes a freehold; it is the former, certainty, that characterizes a chattel real or a chattel interest in realty.
>
> A further helpful definition of 'chattels real' may be found in Tyler & Palmer, Crossley Vaines on Personal Property, 5th Ed. (1973), at pp. 8-9.
>
> 6. In view of the characterization of a petroleum and natural gas lease by the Supreme Court of Canada . . . as profit à prendre for a term certain or an irrevocable licence to win and take substances from the land must, of necessity, be classed as chattels real. Chattels real are interests which issue out of or are annexed to real estate for a specific duration of time and devolve at common law on the personal representative. It is this nature by which they have historically been characterized as personalty at common law.
>
> 7. On the basis of these authorities and the legal nature and characteristics of petroleum and natural gas lease as a profit à prendre for a term certain together with earned working interests therein which also depend in turn upon the term of the lease and production under the lease, it is my conclusion that the "Jennifer interests" are chattels real.

Note that the fifth paragraph above points out that a "chattel real" can be an interest in land, while the sixth paragraph indicates that a "chattel real" can be "personal estate." Mason J. does not deal with the point that may trouble many oil and gas lawyers; he does not expressly deal with the point that a petroleum and natural gas right is an interest in land nor state that a petroleum and natural gas right is both an interest in land and a chattel real, although for purposes of the *Seizures Act* it is only the latter.

The decision of Mason J. appears to be that since a petroleum and natural gas right is a profit à prendre for a term certain (i.e., the fixed term or primary term of the lease), together with working interests therein which depend upon the term of the lease and production under the lease, the Jennifer Interests were chattels real. That is to say, the key point in distinguishing between realty and chattels real appears to be the question of certainty of duration and on that point Mason J. was of the view that the Supreme Court

of Canada had determined that the petroleum and natural gas "lease" involves a grant for a "term certain." Therefore, Mason J. appears to have focused upon the "certain" (or limited) primary term of a lease. He did not view the continuation that may occur for an indefinite period (i.e., for so long as there may be production) as creating the level of "uncertainty of term" required to pass beyond "chattel real" and into "land."

Mason J.'s reference to the characterization given by the Supreme Court of Canada is a reference to *Berkheiser* v. *Berkheiser and Glaister*.[31] The dissenting judgment of Rand J. in *Berkheiser* sets out the view that because oil and gas cannot be owned until severed and controlled, an oil and gas "lease" does not give that level of possession of an indestructible substance which is necessary for it to be an incorporeal hereditament. The majority decision of Kellock J. quotes Halsburys[32] as stating that "[a] profit à prendre may be created for an estate in perpetuity analogous to an estate in fee simple, or for any less period or interest such as a term of years." But Kellock J. found that the provisions of the freehold lease in question were "inconsistent with any conception of a grant in fee whether of the minerals in place or of a profit à prendre."

It is submitted that Kellock J. did not quite characterize the lease as a "profit à prendre for a term certain" as Mason J.'s judgment appears to suggest. Kellock J. stated at page 732:

> In my opinion, the instrument is to be construed as a grant of a profit à prendre for an uncertain term which might be brought to an end upon the happening of any of the various contingencies for which it provides.

It can be argued, therefore, that the *Hamilton Brothers* decision glosses over a key issue, that being the question of whether the level of uncertainty of term described by Kellock J. in *Berkheiser* is sufficient that the oil and gas lease creates "realty" as opposed to a "chattel real." The conventional non oil and gas "lease" is a chattel real but it does not have the continuation aspect of the oil and gas lease. *Berkheiser* may, however, direct us to the "chattel real" conclusion in any event, by a slightly different route. The issue in *Berkheiser* was whether the granting of the lease had conveyed such an interest in the minerals that a devise of land in a will had "adeemed" as to such minerals. In finding that it did not, Kellock J. stated at page 732:

> It did not bring about that separation of the estate in the minerals from the estate in the land apart from the minerals which is the necessary basis for the operation of the doctrine of ademption.

The Supreme Court of Canada in *Berkheiser* found that the granting of an oil and gas lease by the fee simple owner did not cause an ademption of those minerals from a devise of the fee owner's land. This must be reconciled with the principle that the oil and gas lease is a "chattel real" which is still an interest in land. Perhaps the reconciliation is this, *Berkheiser* indicates that no ademption occurred because no conveyance of "real estate"

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31. [1957] 7 D.L.R. (2d) 721 [hereinafter "*Berkheiser*"].
32. 2nd ed., page 386, s. 678.

had occurred. This is because the estate created by the lease is, although an interest in land, not to be treated as land for all purposes. It is an interest in land, but only as a chattel real. The nature of a chattel real is such that it bears some characteristics of a chattel, and one of those is that a grant of a chattel interest does not cause an ademption of a devise of real estate.

Having been through all of the foregoing, one may wonder about the reasons which the draftsmen of the *Seizures Act* had for differentiating between land and chattels real in that Act and how those reasons would apply to the oil and gas lease, as it is understood by businessmen today. If there is to be a fundamental difference between land and chattels real and that difference is to be of some present, practical significance, does it make sense to group working interests in oil and gas property with chattels, as opposed to land?

It is very interesting to note that Mason J. digresses to state that had he found the Jennifer Interests to be interests in land, such that s. 15 as opposed to s. 5 of the *Seizures Act* would have applied, Hamilton would not have been able to execute against them because then s. 15 would have applied and s. 15 requires that the writ be filed with the Registrar of the appropriate land titles office. The Jennifer Interests were such that they could not be registered under the *Land Titles Act*.[33] Mason J. does not fully explain why they could not be so registered, but apparently they were all Crown leases and he felt that the Department of Energy is not covered by the phrase "Registrar of the appropriate land titles office." As Mason J. found such Crown leases to be chattels real, he also did not need to deal with the issue of whether they were equitable interests in land not exigible under a writ of execution.

The decision also contains discussions of s. 177 of the *Bank Act* and the Canadian theory of ownership of hydrocarbons in place and the summary which the decision provides could be used as support for the position that a freehold lessor's royalty may well be an interest in land. Mason J. quotes from Professor Moull of Osgoode Hall Law School and an article entitled "Security Under Sections 177 and 178 of the *Bank Act*"[34] in which Professor Moull states at page 263:

> Section 177 security is in the nature of a fixed charge on real property, or at least on a component part of real property (hydrocarbons and minerals in place) and on the rights, licences and permits that allow the component part to be separated from that real property.... Conceptually, the owner of the lands (often a provincial government) remains the owner of the hydrocarbons and minerals until the person to whom the profit à prendre has been granted recovers or captures them. At that point, the owner of the land usually reserves a share out of the production recovered or captured as its royalty, so that the royalty share remains its property and thus never becomes the property of the holder of the profit à prendre.

Mason J. determines that the "[s]ection 177 security effectively transferred to the Bank the 10% beneficial interests of Jennifer in the petroleum and natural gas rights and the working interests in those producing wells subject to equities of redemption." The Court

33. R.S.A. 1980, c. L-5.

34. (1986), 65 C.B.R. (Special Banking Issue) 242.

seems to view the legal effect of a s. 177 assignment as being more analogous to that of a chattel mortgage than to that of a conventional real estate mortgage, which may result from the influence of s. 178. The tendency is probably to think of s. 177 assignments as real estate mortgages, because their subject matter is made up of interests in land.

Mason J. does not make any attempt to deal separately with those parts of the economic unit making up oil and gas rights which are not comprised of the profit à prendre, but of ancillary rights (i.e., tangible equipment and the various choses in action made up of rights under various kinds of contracts or the one overriding royalty interest). Due to the prominence given in Mason J.'s reasons to the effect of s. 177 assignments, counsel for lenders may wonder what one would have to draft into a debenture or trust deed in order to receive the same favourable treatment relative to unsecured creditors who hold writs of execution and attempt to force a sale of mortgaged property.

B. *Bank of Montreal* v. *Canadian Westgrowth Ltd., Westgrowth Ltd. and Westgrowth Petroleums Inc.*[35]

In this case, original negotiations for the rental by a Canadian parent corporation of a drilling rig owned by Quadrill Resources Ltd. ("Quadrill") were conducted by the parent, however, the final agreement was entered into between the American subsidiary and Quadrill because the subject drilling rig was moved to the subsidiary in Texas after a downturn in drilling activity in Alberta. The bank was the assignee of the rights of Quadrill relative to the subsidiary under the rig rental agreement.

The Court was invited to pierce the corporate veil between the parent and the subsidiary and to find the parent liable for the obligation of the subsidiary. The Court, however, refused to do so finding no fraud and finding that all parties were aware of the inter-relationship of the separate parent and subsidiary.

An alternative argument put forward was that the parent should be liable on the basis of agency (i.e., that the subsidiary was acting as the agent of the parent). The Court determined that a contract of agency would have to be found for that argument to succeed and again concluded that the facts did not support such a finding.

Those of us who have made (or missed) typographical or clerical errors can also take some comfort from the decision. The name of the parent appeared on the signature page of an agreement otherwise expressing itself to be an agreement made by the subsidiary. Neither that, nor the fact that a subsequent acknowledgement of the bank's assignment was signed by the parent (but was subsequently corrected), concerned the Court. These were found to be nothing more than mistakes or oversights, which were subsequently corrected and were held to be of no consequence.

On the corporate veil issue, an employee of the bank testified that he was not concerned that he was taking security from a subsidiary, rather than the parent, he "being

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35. (1990), 72 Alta. L.R. (2d) 319 (Alta. Q.B.).

of the view that Ltd. and Inc. were one and the same company and that Ltd. was simply the name of the company in Canada and Inc. was its name in the United States." There was, however, no "suggestion or evidence that any of the parties involved so informed him." The Court held that the following facts were no more than would be expected in the operation of two associated companies. The subsidiary was wholly-owned by the parent, the officers and directors of the two companies were identical, meetings were held concurrently, the subsidiary was funded entirely by the parent and the subsidiary's assets were purchased with monies loaned by the parent, interest free and with no terms for repayment, the audits for both companies were done in Calgary by the same auditor, each company had the same year end, correspondence with respect to the drilling rig rental contract were dealt with by personnel in the parent's Calgary office with most correspondence being addressed to the parent with several letters on the parent's letterhead referring to "our long term drilling contract" or words to that effect and the parent provided management services to the subsidiary at no cost.

The long established rule with respect to distinct legal entities, as established in *Salomon* v. *Salomon and Co.*[36] was not to be overcome and judgment was awarded against the subsidiary but not the parent. The earlier decision of the Alberta Court of Appeal in *Allarco Group Ltd.* v. *Suncor Inc. Resources Group, Oil Sands Div.*[37] relating to lifting the corporate veil was also referred to.[38]

Another interesting issue in this case resulted from the fact that the drilling rig rental contract was silent on the point of interest. The bank claimed interest pursuant to the *Judicature Act*[39] through to the date of its judgment and under the *Judgment Interest Act*[40] thereafter. Interest was in fact awarded by the Court.

Finally, the decision also includes two other interesting subsidiary points. First, the testimony relating to value given by a particular expert witness was completely discounted because it was shown on cross-examination that his calculations did not take into account many relevant factors to which he should have had regard. It was stated "his failure in this regard can be attributed almost solely to the fact that he had little familiarity with what actually takes place in a drilling operation." Second, the defense argued that it had terminated the drilling rig rental contract pursuant to a clause allowing it to terminate if the management of Quadrill changed substantially. The President of Quadrill had resigned as President, remaining as a director and continuing to work on behalf of Quadrill with respect to the subject matter of the contract. The articles of Quadrill provided that its management would be by the directors. Accordingly, it was held by the Court that the "purported resignation of Mr. O'Shea as President of Quadrill is not a change in the current management of Quadrill as is contemplated by Clause 11 and the defense position in this regard cannot therefore be accepted."

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36. [1897] A.C. 22 (H.L.).

37. 53 Alta. L.R. (2d) 107, [1987] 5 W.W.R. 159, 77 A.R. 378.

38. See also the discussion of the corporate veil issue in the context of *Sturrock* v. *Ancona Petroleums Ltd.*, *infra* note 79.

39. R.S.A. 1980, c. J-1.

40. S.A. 1984, c. J-0.5.

C. *Avonlea Mineral Industries Ltd. (Bankrupt), Re*[41]

On the facts of this case, a builders' lien was effectively given priority over a debenture. A creditor and holder of a builders' lien (which arose under s. 22 of the *Builders' Lien Act*[42]) applied for an interim distribution of accounts receivable realized by the trustee in bankruptcy. Another individual held a registered debenture and resisted the application on the basis that its interest had priority over the lien claim of the builders' lien claimant. The reasons for decision are very short and it would have been useful to have known more about the precise terms, subject matter and perfection of the debenture. The Court read those provisions of the *Builders' Lien Act* which created the lien, took guidance from a previous decision (*Canada Trust Co.* v. *Cenex Ltd.*[43]) which held that "it was intended that those who provide the work and material to sever and extract ore from a mine should have first claim upon it" and concluded that the legislature could not have intended that the interests of a lien claimant could be defeated simply because the subject of the lien was sold, particularly when the subject is readily identifiable. At that point, the reasons become somewhat confusing. The judgment had been considering a lien and a debenture and suddenly the subject matter changes to the issue of sale and the subsequent processing of some of the minerals. The judgment goes on to award priority to the builders' lien.

D. *Bradley Excavating Inc.* v. *Burza Resources Ltd. et al*[44]

In this case, a Master in Chambers of the Alberta Court of Queen's Bench (Grand Prairie) held that the work of a subcontractor in physically removing a sulphur base pad from gas plant lands and transporting the sulphur base pad materials to sulphur forming facilities, constituted an "improvement" to the gas plant lands within the meaning of s. 1(d) of the *Builders' Lien Act*,[45] such that the subcontractor had a lienable claim. The issue of whether this work constituted an "improvement" was interesting because it can be argued that the definition of "improvement" requires that a thing is or is intended to be constructed, erected, built, placed, dug or drilled. Sulphur base pad removal does not seem to satisfy any of these prerequisites. No construction was to follow the removal of the sulphur base pads. It was argued that it was not sufficient that the work resulted in a change or alteration.

Section 1(d) of the *Builders' Lien Act* reads:

> "Improvement" means anything constructed, erected, built, placed, dug or drilled, or intended to constructed, erected, built, placed, dug or drilled on or in land except a thing that is neither affixed to the land nor intended to be or become part of the land.

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41. (1990), 87 Sask. R. 2 (Sask. Q.B.).
42. S.S. 1984-85-86, c. B-7.1.
43. (1982), 13 Sask. R. 435 at 440.
44. (1990), 103 A.R. 118 (Alta. Q.B.).
45. R.S.A. 1980, c. B-12.

In reviewing the authorities, it was the Master's view that British Columbia's definition of "improvement" was closer than Newfoundland's or Ontario's to that in Alberta. British Columbia's definition includes the phrase "and also any clearing, excavating, digging, drilling, tunnelling, filling, grading, or ditching or, in, upon, or under land." Neither Newfoundland nor Ontario builders' lien legislation included "dig" or "drilled" or words of like effect and on that basis the Master distinguished certain analogous situations referred to in judgments from those provinces. Focusing upon the word "dig" in Alberta's definition, the Master held that "it is not stretching the intention of the legislation or judicial interpretation to characterize the work of the Plaintiffs as falling within the definition of the *Builders' Lien Act*." That portion of the work that was not done on the "owner's" property but rather was done at the remelting or forming plant site was, however, held not to be capable of supporting a lien.

E. *Panamericana De Bienes Y Servicios S.A.* v. *Northern Badger Oil & Gas Limited*[46]

Our present coverage of this decision must point out that the Canadian Petroleum Law Foundation has already received an excellent report on it from Donald H. Larson, at page seven of his article "Orphan Wells: We Shall Abandon No Well Before Its Time," presented to the Foundation's Midwinter Conference on February 6, 1991. As MacPherson J. states in his oral judgment, this case involved a "contest between preserving the secured creditor's rights (as protected by the *Bankruptcy Act*[47]), as opposed to saving the public purse" and in this instance the *Bankruptcy Act* prevailed. The Energy Resources Conservation Board (the "Board") had ordered the Court-appointed receiver of Northern Badger Oil & Gas Limited to abandon seven oil wells as there was a potential for pollutants being released from the wells at some future time unless the wells were properly abandoned. A receiving order under the *Bankruptcy Act* was also in place, appointing Collins Barrow Limited as trustee.

The receiver had sold substantially all of the assets of the debtor and with Court approval, had paid out most of the sales proceeds to various secured creditors. The receiver had additional sales proceeds on hand, as well as various still unrealized assets and moved for discharge, permission to pay the remaining sales proceeds to the secured creditors and permission to deliver the rest of the unrealized property to the trustee. The Board moved for an order directing the receiver to carry out the abandonment order prior to obtaining a discharge as receiver.

In his judgment, MacPherson J. stated that:

> The practical issue is whether the cost of abandoning the wells can be ordered by the Energy Resources Conservation Board to be paid out of the funds held by the receiver for secured creditors or funds payable to the trustee in bankruptcy.

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46. (1990), 75 Alta. L.R. (2d) 185 (Alta. Q.B.). Since writing this paper the Court of Appeal has rendered a decision overturning this decision; see Schedule "A" to this paper, *infra* and see (1991), 81 Alta. L.R. (2d) 45.

47. R.S.C. 1985, c. B-3.

MacPherson J. found that the Board's order was within its jurisdiction, that there had been no excess of authority, that there had been no request for a review hearing or appeal and therefore, in light of s. 28 of *Energy Resources Conservation Act*,[48] that the Court had no right to review the order as proper or reasonable. The Board orders were a valid statutory obligation imposed upon the receiver. Thus, the Board's application should succeed if the provisions of the *Bankruptcy Act* did not require otherwise. The Board's claim failed on the following analysis:

(a) the Board is subject to the *Bankruptcy Act*, as are all creditors and its claim would have preferred it to the claim of the secured creditor, contrary to the scheme of distribution of the *Bankruptcy Act*;

(b) the Board's order did not constitute a "claim of the Crown" as contemplated in s. 47(a) of the *Bankruptcy Act* those being restricted to claims secured "by Her Majesty's personal preference," such as claims for taxes; and

(c) although the form of the Board orders related to abandonment of gas wells, their genuine purpose was unconstitutional as it was to take money directed by the *Bankruptcy Act* to be paid to a secured creditor and apply it to another purpose.

The Board had made an able argument as follows:

(a) the real issue in this case is whether the cost of abandoning the wells should be borne by the taxpayers of Alberta or the creditors of Northern Badger, who if not responsible for the costs of abandoning the wells will receive a windfall as the result of the failure of Northern Badger to comply with its statutory duties;

(b) the Board order is directed to the receiver and not to the trustee in bankruptcy, therefore, the *Bankruptcy Act* does not apply;

(c) the order is to do an act of abandonment and as a non-monetary direction is not a claim provable in bankruptcy; and

(d) to say that the order interferes with the scheme of distribution set forth in s. 136 of the *Bankruptcy Act* is due to an overreaching of the *Bankruptcy Act* into environmental matters properly characterized as proper use of civil rights.

The Court had difficulty only with the final argument. MacPherson J. referred to *F.B.D.B.* v. *Que. (Comm. de la santé)*[49] and stated that the Supreme Court of Canada had prescribed the manner in which to deal with contests between the public purse and secured creditors' rights. He then agreed with the dissenting view of the Chief Justice of the United States in the five to four decision of the Supreme Court of the United States of America in *Midlantic Nat. Bank* v. *New Jersey Department of Environmental*

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

49. [1988] 1 S.C.R. 1061, 68 C.B.R. (W.S.) 209.

Protection; *Quanta Resources Corp.* v. *New York (City)*[50] and held that it was for the legislature to change the law, not the courts, when it comes to impairing otherwise valid security for societal purposes. Property rights would only be destroyed on the basis of very clear legislative statement.[51]

A further basis for the decision might have been that the competition was in effect one between a provision in a statute (the *Bankruptcy Act*) and one in an order issued by a regulatory tribunal and the former should carry greater legal authority.

The proposed amendments to s. 20 of the *Oil & Gas Conservation Act*[52] would require receivers, liquidators, bankruptcy trustees and others not only to advise the Board of their appointment but also to abandon all wells licensed to the insolvent party. One queries whether such a legislative provision would have altered the result of this case. We also refer the reader to an article entitled "The Impact of Crown Priorities" by Allan H. McMillan, also presented at the 1991 Mid-Winter Meeting of the Canadian Petroleum Law Foundation, which addresses the consequences of a Crown priority for abandonments to the availability of secured financing.

F. *Bank of Montreal* v. *Arthur Hall*[53]

In this case, the principal issue was the constitutional question of whether a security interest created pursuant to the *Bank Act*[54] may be made subject to the procedures for enforcement of secured interests prescribed by *The Limitation of Civil Rights Act*.[55] The decision also examined the constitutional validity of the relevant provisions of both *The Limitation of Civil Rights Act* and the *Bank Act*. The Supreme Court of Canada reversed the Saskatchewan Court of Appeal's judgment and agreed with the Chambers judge in holding that the bank was not required to comply with the provincial legislation. To quote from page 123 of the judgment:

> The federal banking power empowers parliament to create an innovative form of financing and to define, in a comprehensive and exclusive manner, the rights and obligations of borrower and lender pursuant to that interest. . .. The rights, duties and obligations of creditor and debtor are to be determined solely by reference to the *Bank Act*.

The writers enjoyed the imagery employed on page 123:

> There can be no hermetic division between banking as a generic activity and the domain covered by property and civil rights. A spillover effect is inevitable. The fact that a given aspect of federal banking legislation cannot operate without having an impact on property and civil rights in the provinces cannot

50. 474 U.S. 494, 88 L. Ed. 2d 859, 106 S. Ct. 755 (1986).
51. *Lloyd's Bank Can.* v. *Int. Warranty Co.*, [1990] 1 W.W.R. 749 leave to appeal to S.C.C. refused 70 Alta. L.R. (2d) L (iii).
52. R.S.A. 1980, c. O-5.
53. [1990] 1 S.C.R. 121.
54. R.S.C. 1985, c. B-1.
55. R.S.S. 1978, c. L-16.

ground a conclusion that the legislation is ultra vires as interfering with provincial law where the matter concerned constitutes an integral element of federal legislative competence.

The security interest created by Subsection 178 and 179, while at a variance with provincial law, was intra vires parliament because of the policy reasons behind the creation of the security interest. The security interest met the pressing need to provide, on a nation-wide basis, for a uniform security mechanism so as to facilitate access to capital by producers of primary resources and manufacturers. It freed borrower and lender from the obligation to defer to a variety of provincial lending regimes and facilitated the ability of banks to realize on its collateral. This in turn translated into important benefits for the borrower: lending became less complicated and more affordable.

The manner in which a bank is permitted to realize on its Section 178 security interest is not a mere appendage or gloss upon the overall scheme of the Act but rather the very linchpin of the security interest. It is integral to, and inseparable from, the legislative scheme. Severing the realization provisions would defeat the specific purpose of the *Bank Act* security interest for the banks would then be forced to contend with all the idiosyncrasies and variables of the various provincial schemes.

It was held that there was an actual conflict of operation between s. 178 and 179 of the *Bank Act* on the one hand and ss. 19 through 36 of the *Limitation of Civil Rights Act* on the other. Accordingly, ss. 19 through 36 were held to be inoperative in respect of security taken pursuant to s. 178 by a chartered bank. It was held that it was not open to a provincial legislature to qualify, by requiring the grant of leave by a judge, the absolute right of repossession given and defined in a federal statute, even though the sole effect of the provincial legislation would be to delay the bank's ability to take possession of its security. As the Court stated at page 146, "dual compliance is impossible and application of the provincial statute can fairly be said to frustrate parliament's legislative purpose."

G. *National Bank of Canada* v. *Corbeil*[56]

In this case, the Supreme Court of Canada reversed the decision of the Quebec Court of Appeal[57] and allowed a cross-demand by a defaulting borrower against its bank for the value of goods seized under s. 178 of the *Bank Act*[58] and abandoned by the bank to a third party. The decision seems to be based on the principle, which seems rather obvious, that a bank does not, simply by seizing under s. 178, become the owner of the seized goods with no further obligation to the borrower with respect to the seized assets.

In this instance, the bank had been unable to find a purchaser and was of the opinion that the value of the asset was less than the cost of moving and storing it. The bank had made no effort to abandon the assets to the borrower and to restore the borrower to the position it was in prior to the seizure. The Court of Appeal's rejection of the cross-demand had been based on the finding that there was insufficient evidence that the bank's

56. [1991] 1 S.C.A. 117.
57. [1989] R.R.A. 749, 28 Q.A.C. 152.
58. *Supra*, note 54.

negligence in attempting to sell the merchandise had caused the damage claimed by the borrower. The Supreme Court stated at page 130 that:

> ...(Sections 178 and 179 of the Bank Act) do not further displace or extinguish the rights of the original owner who has provided (goods) as a security for indebtedness.
>
> When NBC decided to renounce its rights in the goods, it also renounced the power to dispose of the goods in the manner described in the Bank Act. NBC could not therefore simply abandon or hand over the goods to a third party. By doing this, NBC acted in complete disregard of Lorac's rights and of its duties towards Lorac.

The reasons go on to reiterate that s. 179 of the *Bank Act* requires the bank to act in good faith. Reference is made to Crawford and Falconbridge, *Banking and Bills of Exchange*,[59] which sets out that a bank must act reasonably to effect a provident sale. The judgment goes on to state at page 131 that:

> ... it was incumbent upon NBC to respect Lorac's interests and to inform Lorac of its intention to abandon its rights in the goods, and to make clear that the goods were Lorac's to deal with.... It abandoned property which it had no right to abandon and thereby deprived Lorac of such property.

The value of the loss was set at the true value of the goods, not the price obtainable upon a distress or forced sale.

H. *National Bank of Canada* v. *Atomic Slipper Co. Ltd.*[60]

In this case, a bank called a secured loan made to a manufacturer, realized on its s. 88(1)(b) *Bank Act* security and sued the manufacturer for the deficiency. In its trial decision ruling on the defences put forward by the manufacturer, the Quebec Superior Court concluded on the evidence that the bank had not acted maliciously and had allowed a reasonable time for payment of the debts. The Superior Court also established that s. 89(4) of the *Bank Act* gave the bank the power to sell goods given as security under s. 88 and was of the view that the manufacturer had waived the notice provided for in s. 89(4).

At the Quebec Court of Appeal, the manufacturer argued that, on a proper reading of the *Bank Act*, the bank had no power to take possession of the goods given as security under s. 88(1)(b) of the *Bank Act*. The Court of Appeal noted that in view of the extraordinary powers conferred by the *Bank Act*, it must be given a restrictive interpretation and concluded that in enacting s. 88(3), Parliament had made it clear that the special powers contained therein (i.e., possession of or seizure of the property covered by the security) are not applicable to security given under s. 88(1)(a) and (b). The bank therefore could not use the *Bank Act* as authority for taking possession of the inventory. With respect to certain contractual agreements as between the manufacturer and the bank

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59. (8th ed. 1986), vol. 1 at 432.
60. (1991), 125 N.R. 161 (S.C.C.).

which conferred a power of seizure, the Court of Appeal held that such agreements were of no force or effect since it was contrary to public policy to take the law into one's own hands and the bank could not give itself the power to do indirectly what the law did not allow it to do directly.

At the Supreme Court of Canada, the principal issue argued by the bank was the validity of the taking of possession of inventory secured pursuant to s. 88(1)(b) of the *Bank Act*. The Court, however, did not address this matter noting at page 179 that:

> It will not be necessary to answer the question of whether the security given under the *Bank Act* gives a bank as of right this power to take possession, without judicial authorization, of inventory given by a manufacturer as security, in the event the latter is in default to the Bank. In the case at bar there was an agreement governing the matter. The debtor's consent to the removal and sale of the goods and the applicability of a valid agreement suffice to decide this issue.

It was the view of the Supreme Court of Canada that the evidence showed that the manufacturer had consented to the taking of possession of the inventory. With respect to the validity of the agreements and the Quebec Court of Appeal's conclusion that they were contrary to public policy and therefore of no force or effect, the Supreme Court stated at page 187:

> It seems clear from reading the provisions setting out the options a bank has in realizing on its security that Parliament intended to be permissive, not limiting. Section 88(3) gives the bank "in addition to . . . any other rights or powers vested in . . . it" additional powers over certain types of goods. This cannot be interpreted as limiting the rights conferred by agreement . . . As to the rule that "no one may take the law into his own hands," this does not apply to the creation or recognition of rights by one party in favour of another either by agreement or by his action, but to their forced execution at the will of one party without judicial authority. It is not contrary to public policy for a debtor to give his creditor the right to take possession in case of default.

As a result, the Court concluded that there was nothing preventing the bank from taking possession of the goods given that it had acquired that right by agreement and the manufacturer had not objected.

I. *Royal Bank of Canada* v. *Saskatchewan Power Corporation*[61]

Please refer to the discussion of this case under Part IV D hereof. The decision deals with Revenue Canada's attempt to obtain "super priority," in a garnishee context, over secured creditors and to extend that super priority to all taxes owing by the debtor.

61. [1990] 2 W.W.R. 655 (Sask. Q.B.).

IV. TAX

A. *Mohawk Oil Company Limited* v. *Minister of Nat'l Revenue*[62]

This decision shows the importance of having tax advice when structuring a settlement.

The taxpayer in this instance had entered into a contract with Phillip's Petroleum Company in 1978 for the turnkey construction and installation of a waste oil reprocessing plant. The plant failed to operate satisfactorily and following extended negotiations the taxpayer received $6,000,000 U.S. in full settlement for its claim which it reported in its 1982 taxation year as a non-taxable receipt.

The Minister argued that the amount was received partly as taxable income and partly as capital, relying on entries in the taxpayer's books. Generally, amounts received as compensation for the breach of a contract are characterized for tax purposes according to the underlying purpose of the payment. In this instance, the Federal Court Trial Division held that the taxpayer had not received the amount as compensation for lost profits or as a reimbursement of a capital expenditure. Rather, it was held that the amount received was paid by Phillip's Petroleum Company as damages to prevent a lawsuit which could have embarrassed Phillip's. Therefore, the amounts were received by the taxpayer as non-taxable receipts.

B. *Foothills Pipe Lines (Yukon) Ltd.* v. *M.N.R.*[63]

The taxpayer in this case was formed (together with other corporations) for the purpose of creating a project to transport Alaskan gas through Canada to the United States. While the northern leg of the pipeline was never built, the consortium did construct the "pre-build" leg of the pipeline in Alberta and Saskatchewan which is now used to transport Alberta gas.

The consortium applied to the National Energy Board ("NEB") in 1982 for permission to add on a special charge to the pre-build pipeline tariff which was to reimburse the consortium members for the expenditures they incurred with respect to the proposed northern leg of the pipeline. The NEB approved the special charge subject to terms and conditions, one of which was that the special charges were to be paid back when the northern leg was built and operational.

The income tax issue concerned whether the special charges received by the consortium members should be included in income. The Crown argued that the amounts should be assessed as income on the basis that the obligation to make the repayment was contingent and that the taxpayer had free use of the funds. The taxpayers argued that the amounts received were not income on the basis that no goods or services had been provided and

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62. (1990), 36 F.T.R. 23 (F.C.T.D.).
63. (1990), 115 N.R. 380 (F.C.A.).

that the amounts had to be paid back. The Federal Court Trial Division had allowed the taxpayer's appeal and held that the amounts were not income.

The Federal Court of Appeal allowed the Crown's appeal, holding that the amounts received by the taxpayers were not set aside either in trust or by the creation of a special reserve but instead were used in the same manner as other revenue receipts. As well, the possibility of any repayment liability was uncertain and contingent and therefore it was neither a present liability nor a deferred liability which are the only reserves specifically permitted in the Act.

C. *Esso Resources Canada Ltd.* v. *M.N.R.*[64]

Between the years 1983 and 1985, Esso Resources Canada Ltd. ("Esso") purchased natural gas for use in a hydrocarbon miscible flood project. Esso applied for a refund of the excise tax it had paid on the gas purchases pursuant to s. 34(2) of the *Excise Tax Act.*[65] By the time Esso applied for the refund, however, both the taxing provision and the refund provision had been repealed and the Minister refused the refund.

The Federal Court of Appeal held that Esso's claim to a refund had accrued or was accruing at the time of the repeal. This right was preserved by paragraph 43(c) of the *Interpretation Act*[66] which provides that a repeal does not affect any accrued or accruing right under the enactment so repealed. In addition, it was held that another refund provision, s. 68(1)(a) of the *Excise Tax Act*, authorized the refund.

D. *Royal Bank of Canada* v. *Saskatchewan Power Corporation*[67]

The *Income Tax Act*[68] contains provisions purporting to give Revenue Canada "super priority" for certain types of taxes owing over the claims of secured creditors. This decision, as well as that of *Touche Ross Ltd.* v. *M.N.R. et al*[69], considered s. 224(1.2) which purports to give the Crown the ability to seize moneys owing to a taxpayer by the taxpayer's debtors to satisfy taxes owing under s. 227(10.1) (i.e., various types of unremitted withholdings that are deducted at source and non-residents' taxes). At issue was whether the Crown could take priority over a secured creditor and whether amendments that had been made to s. 224(1.2) were adequate to enable the Court to distinguish earlier cases stating that s. 224(1) did not provide such "super priority." The Courts held the Crown to have priority, on the basis that s. 224(1.2) impressed the funds in question with a trust for the purpose of payment of the subject taxes.[70]

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64. (1990), 109 N.R. 272 (F.C.A.).
65. R.S.C. 1970, c. E-3.
66. R.S.C. 1970, C. I-23.
67. *Supra*, note 61.
68. S.C. 1970-71-72, c. 63.
69. (1990), 71 D.L.R. (4th) 648 (N.S.S.C.T.D.).
70. We will not attempt in this summary to analyze all of the history or reasoning within the decision; we invite the readers to do that, should the issues be of interest to them. It is of note, however, that some of the analysis used by the Courts in these decisions may form a basis for arguing that the wording of s. 224(1), which is of greater concern since it appears to apply to all taxes, also creates

In so finding, both the Saskatchewan Court of Queen's Bench and the Saskatchewan Court of Appeal disagreed with the interpretation by the Alberta Court of Appeal in *Lloyds Bank Canada* v. *International Warranty Co. Ltd.*[71] The Saskatchewan Courts held that the language of the provision was clear and granted Revenue Canada priority over a prior perfected security interest and deprives the secured creditor of its secured position.

In this instance, a corporate taxpayer had granted the Royal Bank security for its indebtedness to the bank by way of a debenture, a supplemental debenture, s. 178 *Bank Act* security and a general assignment of its book debts. This security was perfected by registration under the *Personal Property Security Act*[72] and the *Bank Act*.[73] The Minister served a third party demand on Saskatchewan Power Corporation requiring it to pay to Revenue Canada all monies owed by it to the taxpayer. Saskatchewan Power Corporation paid the Receiver General amounts totalling $75,808. The Royal Bank applied to the Courts for an order declaring that it, as a secured creditor, was entitled to the $217,119 still owing by Saskatchewan Power Corporation to the taxpayer and an order requiring the Minister to pay over to the bank the sum of $75,808 already received. The Royal Bank's appeal was dismissed as the Court of Appeal held that Revenue Canada's third party demand took priority over the bank's position as a secured creditor and thus Revenue Canada was entitled to the amount of $217,119 in Saskatchewan Power Corporation's hands. In addition, the Saskatchewan Court of Queen's Bench held that it had no jurisdiction to order the Crown to repay any amounts it had received as the Federal Court has exclusive jurisdiction in such matters. This latter issue was not appealed.

This line of cases may be academic as significant amendments to the *Income Tax Act* are in force or awaiting proclamation. These amendments specify the government's intent to provide Revenue Canada with priority.

Secured creditors will be concerned to understand how this decision and the amended s. of the *Income Tax Act* will apply in practice. One queries whether the secured creditor will be able to stop the Crown's interception of funds, perhaps by realizing against the lands and contracts, putting Revenue Canada in a position similar to that of the holder of an assignment of book debts who is in a competition with the holder of fixed security over the land which generates revenue. The issue remains as to whether Revenue Canada's priority will survive for only that brief period after realization until the secured creditor has converted the "debt" into "proceeds of realization" or is the "problem" for secured creditors a more serious one.

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a trust in favour of Revenue Canada rather than merely giving Revenue Canada an extra-judicial attachment right subject to pre-existing third party rights as had been determined in previous decisions regarding s. 224(1)).

71. [1989] 3 W.W.R. 152, 64 Alta. L.R. (2d) 340, 72 C.B.R. (N.S.) 88, [1989] 1 C.T.C. 401, 89 D.T.C. 5279, 94 A.R. 212, additional reasons 67 Alta. L.R. (2d) 150, 74 C.B.R. (N.S.) 244 [leave to appeal to S.C.C. refused].

72. S.S. 1979-80, c. P-6.1.

73. *Supra*, note 54.

V. GOVERNMENT REGULATION

A. *Industrial Gas Users Association* v. *National Energy Board et al.*[74]

This case involved an application for an order requiring the NEB to address the issue of toll methodology in connection with a hearing to consider whether a certificate of public convenience and necessity should be issued to TransCanada PipeLines Limited with respect to the construction of a pipeline expansion.[75] The NEB proposed to simply continue to apply the "rolled-in" toll methodology which had historically been used in connection with TCPL expansions, but the applicants sought to have the NEB adopt an "incremental" toll methodology, which would require the cost of the new construction to be borne primarily by those customers which the expanded pipeline facilities were intended to serve.

The NEB originally refused to entertain the issue of toll methodology in the subject hearings (GH-5-89), stating that the issue had already been decided in the context of an earlier hearing (GH-2-87). In GH-2-87, the NEB heard evidence and argument on this issue and gave reasons indicating that it had decided to retain the rolled-in method. The applicants contended that the NEB's decision not to consider the issue of toll methodology in GH-5-89 was in breach of s. 52 of the *National Energy Board Act*[76] which stipulates that the NEB, in considering an application for a certificate of public convenience and necessity, "shall take into account all such matters as to it appear to be relevant." The NEB had previously advised the applicants that it considered the issue of toll methodology to be a relevant one.

The first issue that Reed J. addressed was the contention by the respondents that the Trial Division of the Federal Court had no jurisdiction to grant the remedies sought. Reference was made to s. 22(1) of the *National Energy Board Act*, which provides that:

> 22(1) An appeal lies from a decision or order of the Board to the Federal Court of Appeal on a question of law or a question of jurisdiction, after leave to appeal has been obtained from that court on application made within one month after the making of the decision or order sought to be appealed from or within such further time as that court or a judge thereof under special circumstances allows.

The respondents argued that the NEB's decision in this case was one which was appealable to the Federal Court of Appeal and, therefore, the Trial Division of the Federal Court had no jurisdiction. After a review of authorities and similar legislative provisions, Reed J. concluded as follows at page 224:

> When Section 22(1) is read in the context of the other sections of the *National Energy Board Act*, it becomes clear, in my view, that the decisions and orders which are appealable to the Federal Court of

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74. (1990), 33 F.T.R. 218 (F.C.T.D.).
75. See, Dennis G. Hart, David A. Guichon Jr., Michael J. Laffin and Michael A. Thackray, "Recent Legislative and Regulatory Developments of Interest to Oil and Gas Lawyers" (1991), 29 Alta. L.R. 223 at 272.
76. R.S.C. 1970, c. N-6.

> Appeal under that subsection are of a final, and not an interlocutory, nature.... The Board's procedural decision in this case does not fall into that category.

Accordingly, Reed J. held that the Trial Division of the Federal Court had jurisdiction.

Having disposed of the jurisdictional issue, Reed J. turned to the merits of the application. The principal argument of the respondents was that s. 52 of the *National Energy Board Act* had to be read with s. 18 of the Act which provides:

> 18. Where under this Act the Board may make or issue any order or direction or prescribe any terms or conditions or do any other thing in relation to any person, the Board may do so either generally or in any particular case or class of cases.

It was argued that the NEB's decision in the earlier GH-2-87 application constituted a generic s. 18 decision with respect to toll methodology and that as a result the earlier decision governed this application. Reed J. held to the contrary, stating at page 227:

> Despite what might be described as the generic focus in the Board's reasons, in GH-2-87, the decision with respect to toll methodology which the Board in fact rendered was very specific. It related only to the specific pipeline expansion in issue....
>
> Subsequent to that decision, two further applications for expanded pipeline facilities were considered by the Board: a $568 million expansion in GH-4-88 and a $709 million expansion in GH-1-89. In the second of these the issue of toll methodology was raised by intervenors as a possible subject to be considered and the Board rejected that request. It was assumed that the rolled-in method would apply, as it had in the past, and as it had been determined was appropriate in GH-2-87.
>
> Some revision of the views expressed by the Board in GH-2-87 did however occur. In a toll rate decision of June 1987 (RH-1-88 Phase II), the Board accepted zone based tolls for domestic volumes and a point-to-point basis for export volumes. The Board expressed reservations about its earlier view that different charges for different customers was discriminatory.

In light of the foregoing, Reed J. could not accept the argument that the GH-2-87 decision was tantamount to a s. 18 type order or directive and concluded that although it was clear that there had been a NEB policy of using a rolled-in toll method, one could not conclude that this policy was anything more than just policy. Reed J. therefore held that the NEB was required to address the toll methodology issue in of the GH-5-89 hearing.

As a matter of interest, in its reasons for decision in respect of GH-5-89 the NEB concluded that the subject TCPL expansion costs should be rolled into TCPL's rate base for toll purposes, but did not state that its conclusions in respect of toll methodology were to be considered applicable to future expansions. It did, however, note that it expects that there would have to be a clear demonstration of radically changed circumstances before the issue of tolling methodology would warrant re-examination.

By way of editorial comment, the Court's decision here was logical. The NEB found the toll methodology issue relevant, the NEB refused to consider the issue and therefore

the NEB had fettered its jurisdiction. The problem with the decision as we see it is that arguably, the NEB in all subsequent cases, might be obliged to review every toll methodology issue. This seems to ignore the fact that adherence to policies of administrative tribunals if often a practical necessity and in this instance it seems questionable to impose upon the NEB the requirement that it either abandon its policies governing toll methodology or, in the alternative, conduct symbolic hearings and hear discredited arguments.

B. *Kennibar Resources Ltd.* v. *Saskatchewan (Minister of Energy and Mines) and Gulf Canada Resources Ltd.*[77]

This case involved an application by Kennibar Resources Ltd. ("Kennibar") for an order quashing an order of the Minister of Energy and Mines for the province of Saskatchewan granted under the *Oil and Gas Conservation Act.*[78] In May, 1990 Gulf Canada Resources Limited ("Gulf") had applied to the Minister for permission to drill and develop a horizontal well in a pool which traversed several legal subdivisions. At the same time Gulf requested that the well be given "good production practice" status which would permit Gulf to regulate its own levels of production and to produce the well without regard to production limits. In its application Gulf claimed that the only wells which might be affected by the horizontal well were those owned by Gulf. Kennibar claimed that four of its wells, which were in close proximity to Gulf's proposed horizontal well, would be adversely affected by the Gulf well in that drainage into the horizontal well would occur.

Notwithstanding Kennibar's opposition, on July 13, 1990 the Minister approved Gulf's application, assigned the horizontal well a four legal subdivision drainage unit and granted it good production practice ("GPP") status. On July 18, 1990 Kennibar applied for a hearing by the Oil and Gas Conservation Board with respect to the granting of GPP status to the Gulf well. On July 26, 1990, without having given Kennibar a hearing, the Minister rescinded the original order and replaced it with another order which had some minor changes but which did not affect the approval of Gulf's application and/or the granting of GPP status to the well. On August 27, 1990 Kennibar made a second application to the Minister for a hearing. This second request for a hearing was denied.

Kennibar claimed that the Minister had committed a reviewable error of law in making the decision to issue the subject order. Kennibar relied on certain provisions of the *Oil and Gas Conservation Act*, notably s. 3(c) and (d) and s. 25, which provide that:

> 3. The purposes of this Act are:
>
> (c) to protect the correlative rights of each owner;

[77] (1990), 88 Sask. R. 35 (Sask. Q.B.).

[78] R.S.S. 1978, c. O-2.

> (d) to enable each owner to obtain his just and equitable share of the allowable production of any pool...

and

> 25. The minister shall by order establish drainage units of uniform size and shape for a field or pool...

With respect to s. 3 of the Act, Kennibar claimed that in giving the Gulf well GPP status the Minister failed "to protect the correlative rights of" Kennibar and failed "to enable each owner to obtain his just and equitable share of allowable production of any pool." However, as a result of numerous conflicting affidavits filed with respect to the issue of drainage, no finding was made by the Court in this regard, Scheibel J. stating at page 45:

> I have already indicated it is not possible to make a finding, on this application, in respect of drainage. If there is no drainage, then there is no interference with the correlative rights of the applicant, nor is there any interference with the applicant obtaining its just and equitable share of the allowable production. On that basis, the action taken by the Minister is not inconsistent with the OGCA, and there is no error of law in respect to section 3 of the OGCA.

With respect to s. 25 of the Act, Kennibar argued that the Minister had violated the provisions of that section by assigning Gulf's horizontal well a drainage unit comprising four legal subdivisions. Gulf took a consequentialist approach and claimed that s. 25 did not preclude the assignment of four legal subdivisions to the drainage unit because, if wells were limited to one legal subdivision, the drilling of horizontal wells would effectively be precluded. In response to these arguments Scheibel J. states at page 46 that:

> It is clear from the arguments advanced by all parties that horizontal drilling is a relatively new technology in this province. The legislation does not contemplate issues arising from this technology and the problem lies in the failure of the Act and the Regulations to keep pace with the new advances in the industry.
>
> By virtue of Section 25 of the Act it is mandatory for the Minister, by order, to establish drainage units which are uniform in size and shape for each pool. In compliance with this mandatory direction, the Minister, in respect of this "pool," ordered the uniform size and shape of the subject drainage unit be comprised of one legal subdivision.

Scheibel J. accordingly concluded that the Minister had committed an error of law on the face of the record by assigning four legal subdivisions to the Gulf well, and the Minister's order was quashed.

As a result of this decision, the government of Saskatchewan put licences for new horizontal wells on hold and, as at December, 1990, more than forty licence applications were affected. Legislation addressing this issue (Bill 73) was tabled in the Saskatchewan legislature on May 1, 1991, and received Royal Assent on June 18, 1991. Under this new

legislation, the Minister has the discretion to deal with a situation such as the one arising in this case and to specifically acknowledge the horizontal well technology.

VI. CONTRACTS

A. *Sturrock et al* v. *Ancona Petroleums Ltd.*[79]

By a series of participation agreements the plaintiffs in this action agreed with Ancona Petroleums Ltd. to participate as farmees in a farmout arrangement whereunder the plaintiffs and Ancona would earn interests (including interests in certain equipment) by drilling, completing and equipping or plugging and abandoning five test wells on certain farmout lands, Ancona operating the properties. The test wells were drilled and completed in May, 1980 and four of the wells produced intermittently until January, 1981. On March 23, 1981 Thomas C. Clare, president of Ancona, wrote each plaintiff stating in part that:

> With regard to the captioned project, please be advised that the four producing wells (1-25, 9-25, 16-25, 9-27) have sanded up and consequently, have quit producing. In order to put each well back on production, workover operations, with a service rig will have to be conducted. Considering the present status of the petroleum industry and the negative effect of current governmental regulations, coupled with low wellhead price for oil, Ancona, as operator for the Lashman project, does not recommend the expenditure to re-work the aforementioned wells in order to place them back on production. Alternatively, it is recommended that the wells remain shut-in to avoid incurring further financial loss as we have in the last few months of production.

The plaintiffs authorized Ancona to shut-in the wells and to secure the area to avoid theft and vandalism. In July, 1981 Clare contacted an equipment service supply company and requested that they remove the equipment which would deteriorate and be subject to theft or vandalism and store such equipment in their yard. In November, 1981 Clare was contacted by a representative of the service company and was advised that they had a prospective buyer for the stored equipment. An offer of $95,000 was made for the equipment, and Clare accepted this offer without the approval of, or notice to, the plaintiffs. The purchase price for the stored equipment was paid by cheque made payable to Lugano Enterprises Ltd., and the $95,000 was deposited into Lugano's bank account on November 3, 1981. On November 4, 1991 Lugano transferred $35,000 to the personal account of Clare, who acknowledged that this amount was taken for personal expenses. On November 5, 1981 Lugano transferred $59,000 to the account of Ancona and on the same day Ancona issued certified cheques for $28,047.74 and $31,857.58. Clare did not know what these certified cheques were for and did not have copies of the cancelled cheques. Among other things, the plaintiffs claimed damages from Clare for fraudulent misappropriation of the oilfield equipment and the proceeds of sale therefrom.

Clare submitted, with respect to the sale of the well equipment, that Ancona as operator had the inherent authority to deal with the well equipment despite there being no express

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79. [1990] 75 Alta. L.R. 216 (Alta. Q.B.).

authority in the participation agreements for the operator to dispose of equipment. Lomas J. held otherwise, stating at page 242:

> In my opinion Ancona did not have the right to dispose of the equipment without the approval of the other participants. The evidence clearly established that the other participants authorized Ancona to leave the wells shut-in and to secure the area to avoid theft and vandalism. They did not authorize Ancona to sell the equipment and never approved the sale.

Although no operating procedure was prepared in connection with the participation agreements, Clare referred to Clause 507 of the 1981 CAPL Operating Procedure and contended that this clause gave Ancona the right to commingle funds received through the operation of the farmout lands with other funds, and Ancona was accordingly not in breach of its obligations under the participation agreements by dealing with the proceeds of sale from the well equipment as it did. Clause 507 of the 1981 CAPL Operating Procedure provides that:

> 507 COMMINGLING OF FUNDS - The Operator may commingle with its own funds the moneys which it receives from or for the account of the Joint-Operators pursuant to this Operating Procedure.

In response to this contention Lomas J. stated at page 240:

> I cannot accept this contention. Firstly Clause 507 of the CAPL Operating Procedure was not contained in any agreement between the parties to this litigation. Secondly the clause, if it did apply, only permitted the operator to commingle monies received from or for the account of the Joint-Operators "with its own funds." Ancona did not commingle the proceeds from the sale of the equipment with its own funds. Those proceeds were paid to Lugano, who then transferred $59,000 to Ancona, $35,000 to Clare personally (which Clare admits was used for personal expenses) and Lugano retained the remaining $1,000. Ancona , in turn, upon receipt of the $59,000 issued two certified cheques totalling $59,905.32.. . . This use of funds does not amount to commingling of the funds as permitted by Clause 507 of the CAPL form of Operating Procedure. Thirdly, Clause 507 of the CAPL form of Operating Procedure was considered by the Alberta Court of Appeal in *Bank of Nova Scotia* v. *Societe General* (Canada) *supra* at p. 238. There the court noted that the existence of the clause did not permit the operator to use the funds in question for its own use.

Accordingly, Lomas J. concluded that neither Ancona nor Clare was permitted to use any of the equipment or funds for their own use and Ancona was therefore in breach of its obligations under the participation agreements.

Lomas J. also found that Ancona was in a fiduciary position vis-à-vis the plaintiffs, and referred to specific provisions in the participation agreements as the basis for so finding. Lomas J. stated at page 235:

> Those provisions clearly show that Ancona was to conduct all operations for the parties to the Participation Agreements in accordance with good oilfield practice. In conducting those operations Ancona was clearly in a fiduciary relationship with the other parties to the Participation Agreements and, to the extent Ancona held property or received money in connection with such operations, it held such property and money in trust for the parties to the Participation Agreements with the obligation to use the

same solely for the benefit of such parties in proportion to their respective undivided working interests therein.

Counsel for Clare argued that, while Ancona may have been in a fiduciary relationship with the plaintiffs, Clare as president and controlling shareholder of Ancona was not. Counsel submitted that Ancona was a distinct legal entity and the corporate veil should not be pierced. In dismissing this contention and determining that the corporate veil should be lifted in this instance, Lomas J. referred to a line of cases which justifies lifting the corporate veil in those circumstances wherein there is fraud or improper conduct on the part of the controlling shareholder. Lomas J. at page 249 concluded that:

> I am satisfied there is ample evidence here of fraud or improper conduct by both Ancona and Clare. The improper conduct by Ancona is referred to above. Clare was the president and controlling shareholder of Ancona. . . Clare gave instructions to remove the well equipment and approved the sale of that equipment in 1981. He failed to get approval, or to even advise the participants, of the sale.. . He personally took at least $35,000 from the proceeds of the sales of the equipment and used that money for personal expenses.

Each plaintiff was accordingly awarded judgment against Clare for its proportionate share of the value of the equipment sold.

With respect to the question of the intention of Clause 507 of the 1981 CAPL Operating Procedure, and the Alberta Court of Appeal's decision in *Bank of Nova Scotia* v. *Societe General (Canada) et al*,[80] it is of interest to note that the 1990 version of the CAPL Operating Procedure has expanded Clause 507 to read as follows:

> 507 COMMINGLING OF FUNDS - The Operator may commingle with its own funds the moneys which it receives from or for the account of the Joint-Operators pursuant to this Operating Procedure. Notwithstanding that moneys of a Joint-Operator have been commingled with the Operator's funds, the moneys of a Joint-Operator advanced or paid to the Operator, whether for the conduct of operations hereunder or as proceeds from the sale of production under this Operating Procedure, shall be deemed to be trust moneys, and shall be applied only to their intended use and shall in no way be deemed to be funds belonging to the Operator, other than in its capacity as the Joint-Operators' trustee.

Even with this clarification, however, Joint-Operators will still be faced with the often difficult task of tracing trust funds through the corporate commingled bank account of an Operator which will probably be insolvent, the prospect of which has in the past prompted some Joint-Operators to insist on deleting from the governing operating procedure the Operator's right to commingle funds.

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80. [1988] 4 W.W.R. 232 (Alta. C.A.).

B. *Husky Oil Operations Ltd.* v. *Forest Oil Corp.*[81]

The facts under consideration in this appeal are relatively complex, but are important to an understanding of the Court of Appeal's decision.

Canadian Superior Ltd. and Teck Corporation Ltd. were lessees and partners in an Alberta Crown petroleum and natural gas lease, the subject lands being referred to as the "Joint Lands." In 1980 Texas Pacific entered into a letter of intent with Canadian Superior and Teck (the "Letter of Intent"), which provided in part that:

> When [Texas Pacific] earns a working interest in the... Joint Lands..., it shall be operated pursuant to the provisions of... the 1974 CAPL Operating Procedure and the 1976 PASWC Accounting Procedure, which shall both incorporate those elections as described in the attached Schedule "B."

Schedule "B" to the Letter of Intent sets out in point form the elections. Of primary significance was the CAPL Operating Procedure Clause 2401(A) election.

Canadian Superior and Teck accepted the terms and conditions of the Letter of Intent, however, it was a term of their acceptance that Canadian Superior prepare a more formal agreement. Under the Letter of Intent, Texas Pacific committed to do certain seismic work on the Joint Lands, and undertook to elect on or before July 31, 1981 whether or not to drill an exploratory well. As no formal agreement was immediately prepared by Canadian Superior, Texas Pacific performed the requisite seismic work and committed to drill the exploratory well according to the terms of the Letter of Intent.

Notwithstanding that Schedule "B" to the Letter of Intent provided that the operating agreement would contain a Clause 2401(A) consent election, the first draft of the formal agreement circulated in January, 1981 appended an operating procedure with a Clause 2401(B) right of first refusal election. In August 1982, while negotiations with respect to the formal agreement continued, Husky Oil Operations Ltd. agreed to participate with Texas Pacific in the drilling of the exploratory well and was provided with the first draft of the formal agreement. Husky subsequently wrote to Texas Pacific with comments and suggestions on the initial draft of the formal agreement, and in its letter Husky referred to Clause 2401 of the 1974 CAPL Operating Procedure and stated:

> Husky insists upon the election "B." In the event a party wishes to assign all or part of its interests herein, Husky believes the other parties should have a right of first refusal.

During the period of time in which the formal agreement was being negotiated, Forest Oil Corporation, who intended to drill an exploratory well on lands adjoining the Joint Lands (the "Forest Lands") was attempting to acquire working interests in the Joint Lands and an adjoining section of land held by Husky (the "Husky Lands"). Forest could not persuade Husky to farm out any of Husky's earned interests in the Joint Lands, but was successful in obtaining an informal option to earn an interest in the Husky Lands by

81. [1991] 79 Alta. L.R. (2d) 134 (Alta. C.A.).

performing some seismic work and by agreeing to give Husky well information from the exploratory well to be drilled on the Forest Lands. Forest was also at this time pursuing negotiations with Texas Pacific with respect to the Joint Lands. Both sets of negotiations became important to Forest as in the interim it had drilled a successful exploratory well on the Forest Lands. Forest's concern, however, was that to test this well would be to reveal information which Forest would otherwise want to keep confidential. Accordingly, Forest decided to postpone testing until it had entered into an agreement with Texas Pacific relating to the Joint Lands, and had settled the precise wording of its option arrangement with Husky relating to the Husky Lands.

Texas Pacific then prepared and delivered to all parties with interests in the Joint Lands, other than Husky, a draft seismic option agreement respecting Forest's participation in the Joint Lands. This draft agreement appended a CAPL Operating Procedure specifying a Clause 2401(B) election, which Texas Pacific represented was the operating procedure governing the Joint Lands. Forest therefore believed that Husky had a right of first refusal with respect to the Joint Lands. At the same time Husky was pressing Forest for well information pertaining to the successful exploratory well on the Forest Lands pursuant to their informal option agreement, and was complaining of Forest's breach of contract in withholding such information. Forest accordingly agreed to deliver its exploratory well information to Husky in return for Husky agreeing to limit its right of first refusal by entering into a participation agreement with Forest with respect to the Joint Lands (the "Participation Agreement").

A few days after the Participation Agreement was entered into, another participant in the Joint Lands prepared yet another draft of the formal agreement in respect of the Letter of Intent, which draft's operating procedure contained a Clause 2401(A) consent election. This was the first draft of the formal agreement to reference a Clause 2401(A) election rather than a Clause 2401(B) election. Immediately upon receipt of this document, Texas Pacific realized its mistake in preparing the seismic option agreement for Forest on the Joint Lands and immediately notified Forest of the mistake. Forest then asked to review the title documents governing the Joint Lands and following its review advised Husky that Forest was not bound by the Participation Agreement because the same had been executed by both parties under their mutual mistake that Husky held a right of first refusal with respect to the Joint Lands. Forest claimed that as a result the Participation Agreement was null and void.

As reported in last years paper,[82] at trial Mason J. concluded that Husky did not have a right of first refusal in respect of the Joint Lands, and that the parties entered into the Participation Agreement on the basis of a common mistake. As a result, the Participation Agreement was declared void *ab initio*. In allowing Husky's appeal, Cote J. "emphasizes several things" at page 144:

> First, [the Participation Agreement] does not mention there (or anywhere else) the 1980 Letter of Intent. It describes only the draft 1981 formal agreement. Second, all the existing drafts of that 1981 formal

82. *Supra*, note 21.

agreement did give a right of first refusal. So [the Participation Agreement] is literally correct. It contains no error or misunderstanding.... That alone could be enough to end the suit.

Cote J. went on to observe that:

Forest could get an interest in the Joint Lands only under a proposed formal seismic review option. It was accepted in principle by all the owners other than Husky, but not signed. It incorporated the 1974 Operating Procedure giving election 2401 B right of first refusal to all owners. As described above, the owners dealt with the Joint Lands only under drafts of the 1981 formal agreement, which all had agreed to sign once its terms were worked out. All these drafts of the 1981 formal agreement also included election 2401 B, a right of first refusal. . . Forest and Husky both knew that neither of these draft formal agreements was signed. Both knew that the various parties were free to negotiate changes in the wording before the final versions were settled and signed.

Cote J. accordingly could not see how either Husky or Forest could have thought that there was any real certainty in the situation, and went on to state at page 145 that:

No one disputes that parties may validly contract about uncertain rights or claims. One cannot later attack such a contract (for mistake, failure of consideration, or frustration), just because the uncertain rights or claims ultimately fail.

Cote J. then proceeded to address the issue of consideration, making reference to a line of cases dealing with compromises, and noting the following passage from Halsbury's:

A compromise of a disputed claim which is honestly made, whether legal proceedings have been instituted or not, constitutes valuable consideration, even if the claim ultimately turns out to be unfounded. It is not necessary that the question in dispute should be really doubtful. It is sufficient if the parties in good faith believe it to be so, though such belief is founded on a misapprehension of a clear rule of law.[83]

Cote J. then concluded that, contrary to the view of Mason J., it was irrelevant whether Husky actually had a right of first refusal, so long as at the relevant time Husky thought and claimed it had such a right. In *obiter*, on page 147, Cote J. stated:

Besides, it is very hard to say whether Husky really had a right of first refusal in the 1981 formal agreement. The reasons for judgment at trial show the difficulty in elaborate detail. In particular, they find that by conduct over some years the parties adopted parts of the draft 1981 formal agreement over the Joint Lands. Those reasons contain many pages of difficult analysis. They elaborately dissect and order evidence, some disputed, about events around the time of the [Participation Agreement], and events after that. Then the reasons eventually conclude that Husky did not have a right of first refusal. So they just find that part of the draft 1981 agreement was not one of the parts which were adopted. But Forest was in a hurry to contract with Husky in February, 1985. It had neither the time, nor the inclination, to sort all that out. . . Nor could Forest have done so readily. The trial judgment found that the evidence was conflicting and difficult.

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83. 7 Hals. Laws 144, 2d ed.; 9 Hals. Laws 194, 4th ed..

In essence the Court of Appeal concluded that the Participation Agreement was in the nature of a compromise in that it made certain an uncertain situation which otherwise existed between the parties. Husky's release of its claimed right of first refusal constituted good consideration for this compromise even if its claim was ultimately determined to be ill-founded. The only requirement to uphold the validity of the Participation Agreement on the basis of compromise was that Husky honestly believed that it had a right of first refusal with respect to the Joint Lands at the time the compromise was effected.

Of additional interest in assessing the Court's conclusions is the following excerpt on page 151 of Cote J.'s reasons:

> There is also a public policy issue in all this. The courts encourage parties to settle their differences amicably without resorting to law: 12 C.J. 336-37; Cheshire and Fifoot's Law of Contract 72 (10th ed. 1981). In fast-moving matters like the oil business, that is often the only practical course. When experienced oil companies enter into what objectively appears to be a compromise of uncertain rights, the courts are slow to upset that. It makes no difference that one of the parties might have got the same result much cheaper another way, or by waiting longer.

The writers would suggest that the fact that Forest reviewed title documentation pertaining to the subject lands after entering into the Participation Agreement may have been strong motivation for the Court to uphold its validity. Also telling are the Court's statements referred to above. As a result of this predisposition to find in favour of Husky, in our view the Court's reasons here evidence result-orientated reasoning and are relatively weak.

The finding by the Court of Appeal of no common mistake based on a literal interpretation of the Participation Agreement strikes one as being rather technical given that reference to the Clause 2401(B) election in the draft Operating Procedure being circulated for review and comment was apparently an error in and of itself. The second basis for upholding the validity of the Participation Agreement (i.e., on the basis of compromise) is more satisfactory, however, even here the Court's reasoning seems to suffer from an internal inconsistency. The Court in its reasons suggests that both parties were aware of the uncertainties relating to the underlying title documentation while at the same time the Court does not question Husky's honest belief that it held a right of first refusal.

C. *Ontex Resources Ltd.* v. *Metalore Resources Ltd.*[84]

Brookbank-Sturgeon Mines Limited owned 100% of a mining property comprised of eighteen leasehold claims. In 1981 George Chilian, president of Metalore Resources Ltd., inquired whether Brookbank-Sturgeon would be interested in an option or a joint venture with respect to the subject property, and an agreement was entered into (the "1981 Agreement") between Metalore and Brookbank-Sturgeon which gave Metalore the

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84. (1990), 75 O.R. (2d) 513 (Ont. G.D.).

exclusive right to acquire leasehold interests in the property for a period of ten years. The 1981 Agreement further provided that if Metalore expended $1,000,000 on the property, set out a drilling program and agreed to spend further sums totalling $5,000,000 or more, Brookbank-Sturgeon would have the choice of either:

(a) transferring the property to Metalore in return for a 30% net royalty interest; or

(b) granting Metalore a 60% ownership and retaining a 40% ownership and entering into a joint venture agreement.

The 1981 Agreement placed a two-part disclosure obligation on Metalore. Brookbank-Sturgeon (which was succeeded by Ontex Resources Ltd. through amalgamation) was entitled to information on demand from Metalore, and Metalore was also obliged to provide a yearly report. For 1982 Metalore provided Ontex with a report (the "Skrecky Report") authored by a geologist who by his own assessment was inexperienced. The Skrecky Report was not particularly favourable and, unknown to Ontex, Metalore had asked another, more experienced, geologist to analyze the Skrecky Report and to produce a new report. While this subsequent report (the "Winter Report") was based upon the original data, it offered opinions and interpretation that went beyond the Skrecky Report, and identified an area with relatively favourable potential. The existence of the Winter Report was not disclosed to Ontex.

Subsequent to receiving the Winter Report, Metalore commenced negotiations with Ontex to increase Metalore's interest in the property. It is also of note that in its 1982-83 drilling program Metalore refrained from drilling the area identified in the Winter Report as having the greatest potential. In 1983 the 1981 Agreement was renegotiated, with the resultant new agreement (the "1983 Agreement") increasing Metalore's interests in the property. In January, 1984 Metalore drilled in the area identified in the Winter Report as having the greatest potential. The assay results from the resulting drill hole were extraordinarily good and constituted a "very significant discovery." However, it was not until March, 1986 that Metalore announced its discovery, and by this time it had acquired an additional 227 adjacent mining claims. Following the announcement Ontex commenced an action against Metalore based on breach of contract, fraud, misuse of confidential information and breach of fiduciary duty.

Montgomery J. determined that certain material facts were intentionally withheld from Ontex by Metalore at the time of the negotiations leading up to the 1983 Agreement, and that the same constituted "nothing short of artful deception." In assessing the ramifications of Metalore's actions he concluded, at page 539:

> The breaches of the 1981 and 1983 agreements previously outlined require rescission of the contracts. The 1981 agreement constituted a common enterprise between the parties. The conduct of Chilian has fractured the ability of these parties to continue to work together. The trust, the confidence, the good faith has been blasted away by the conduct of one party.... There has been a total failure to make full and complete disclosure both under the mandatory and request aspects of the contract.

Later on in his reasons, and again dealing with rescission, Montgomery J. stated, at page 549:

> A breach by one party to a contract that goes to the core, heart, root or essence of the contract allows the other party to treat the breach as repudiatory and to rescind the contract.

With respect to the issue of the alleged misuse by Metalore of confidential information to acquire the adjacent mining claims, Montgomery J. made reference to the Supreme Court of Canada's decision in *Lac Minerals Ltd.* v. *International Corona Resources Ltd.*,[85] and observed at page 550 that:

> ...all five members of the court agreed that when information of a confidential nature is disclosed by one party to another in circumstances that would lead the reasonable business person to appreciate that the information is confidential and to expect that the recipient would respect that confidence, the confidant is precluded from using the information for personal gain. No evidence has been led to show that Metalore was entitled to use this information for its own benefit.
>
> Mr. Justice La Forest, speaking for the majority on the issue of remedy in *Lac*, held the constructive trust to be appropriate. In my view, the three part test of breach of confidence (disclosure of confidential information, an awareness on the part of the recipient of the confidential nature of the information and the use of the information to the detriment of the disclosing party) has been met. Although Metalore "developed" the information it was placed in a position to do so by virtue of being Ontex's operator on its lands. I, therefore, conclude that Ontex has established a breach of confidence by Metalore. In my view, the only appropriate remedy is one *in rem*. I conclude that Metalore holds all the staked claims... under a constructive trust for Ontex.

Notwithstanding the fact that Montgomery J. had disposed of the issues before the Court on other grounds, he also considered the issue of fiduciary duty and again referred to the *Lac Minerals* decision with special reference to the "certain common characteristics" frequently present in relationships that have been held to be fiduciary in nature, those characteristics being that:

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

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

(c) the beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

In concluding that a fiduciary relationship did exist as between Metalore and Ontex, Montgomery J. stated, at page 553:

> Applying Wilson J.'s three characteristics of a fiduciary duty... I find as follows:

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85. [1989] 2 S.C.R. 574 [hereinafter "*Lac Minerals*"].

1. Metalore was conducting exploration work on Ontex property for their mutual benefit and was in total control of information from the property. The power of Metalore to conceal information was almost total. There was, therefore, scope in the fiduciary for the exercise of the power of discretion.

2. Metalore was able to unilaterally exercise that power in a way that affected Ontex.

3. Ontex was peculiarly vulnerable and at the mercy of Metalore as Metalore was in complete control of the explorations and of the information released by it.

In the context of use of confidential information, it is of interest to note that Clause 1801 of the nineteen 90 CAPL Operating Procedure now provides in part that:

> 1801 CONFIDENTIALITY REQUIREMENT - Each party entitled to information obtained hereunder or pursuant to the Agreement may use such information for its sole benefit.

As stated in the CAPL annotations in respect of the 1990 Operating Procedure, the inclusion of this provision is intended to eliminate any argument of constructive trust if a party uses joint information to acquire adjacent lands for its own account when there is no express area of mutual interest provision. One would have to imagine that this revised Clause 1801 will give rise to a proliferation of area of mutual interest provisions.

D. *Matchett* v. *Blue Gold Drilling et al.*[86]

On May 12, 1988 Blue Gold Oil and Gas Limited and W.W.S. Resources Limited ("W.W.S.") entered into a joint venture agreement (the "Exploration Agreement") under which W.W.S. was given exclusive management and control of the operations of a joint venture to conduct a nineteen month program of acquiring interests in oil and gas properties for exploration and development. Pursuant to the terms of the Exploration Agreement, Blue Gold was to be the owner of a 51% undivided interest in the joint venture assets and earnings, and was to contribute 51% of the joint venture's exploration and development costs. W.W.S. and an outside participant to be arranged by W.W.S. and approved by Blue Gold were to be the owners of the remaining 49% undivided interest in the joint venture assets, and were to contribute 49% of the exploration and development costs of the joint venture. Among other things, the Exploration Agreement expressly obligated W.W.S. to "submit all Prospects in Canada to Blue Gold until the termination of the Joint Venture Period."

The evidence established that Blue Gold preferred to participate in joint ventures limited to twelve month terms, but that it reluctantly agreed to enter into the Exploration Agreement on the representation of Mr. Lee Matchett (president and controlling shareholder of W.W.S.) that Conwest Exploration Limited (the outside participant proposed by W.W.S.) wanted a joint venture with a nineteen month term. In fact the June 1, 1988 agreement entered into between W.W.S. and Conwest in purported

86. (1991), 78 Alta. L.R. 246 (Alta. Q.B.).

satisfaction of W.W.S.'s obligation to find an outside participant (the "1988 Conwest Agreement") had a term of seven months, and provided Conwest with an option to extend the term for a further twelve months. Conwest did not exercise this extension option, and Conwest's participation obligations under the 1988 Conwest Agreement accordingly terminated at the end of 1988.

The evidence also established that an incentive for Blue Gold to enter into the Exploration Agreement was the fact that it wished to participate in an area known as the "Bigstone Area" of Alberta, and Mr. Matchett had informed it that this might be possible as a participant in a 1987 joint venture agreement (the "1987 Conwest Agreement") involving Conwest and W.W.S. was in default with respect to contributions under that agreement, and Blue Gold might be able to purchase its interest.

W.W.S. failed to meet minimum expenditure obligations for the 1988 calendar year, and had by January, 1989 drilled only five wells, all of which were dry. W.W.S. also failed to arrange for the "outside participant" required to fill in for Conwest for the 1989 calendar year, and was unable to demonstrate that it had put together a proper drilling program for 1989. As a result, on January 19, 1989 Blue Gold Drilling Limited (successor by novation to Blue Gold Oil and Gas Limited) sent W.W.S. a letter stating that it would terminate both the Exploration Agreement and a collateral consulting agreement with Mr. Matchett (the "Consulting Agreement") as of February 28, 1989.

By letter dated January 26, 1989 Mr. Matchett requested Blue Gold to advise whether it intended to fulfil its obligations under the Exploration Agreement and the Consulting Agreement until the end of their stated terms. Blue Gold did not respond to this letter.

In February, 1989 a representative of Blue Gold became aware through a news publication that Conwest and W.W.S. had purchased leases in or adjacent to the Bigstone Area in November, 1988 (i.e., subsequent to the entering into of the Exploration Agreement). On further investigation, Blue Gold ascertained that Conwest and W.W.S. had drilled two wells in the Bigstone Area, and that these wells were located on lands which were not covered by the 1987 Conwest Agreement. Some considerable time later Blue Gold discovered that these two wells had been drilled pursuant to a second June 1, 1988 agreement between Conwest and W.W.S. (the "Undisclosed Conwest Agreement"), which agreement had been entered into subsequent to the entering into of the Exploration Agreement. The Undisclosed Conwest Agreement provided for a Conwest/W.W.S. exploration and development program in respect of an eight township area in and around the Bigstone Area.

On March 3, 1989 W.W.S. and Mr. Matchett sent Blue Gold a letter noting that Blue Gold had failed to make monthly "geological cost" and consulting fee payments due March 1, 1989, and advising that the Exploration Agreement and the Consulting Agreement were accordingly being rescinded "due to your fundamental breach of same." W.W.S. and Mr. Matchett commenced an action seeking to recover damages from Blue Gold, and Blue Gold counterclaimed for repayment of all monthly geological cost payments made to W.W.S. under the Exploration Agreement, and all monthly consulting fee payments made to Mr. Matchett under the Consulting Agreement.

Prowse J. found that W.W.S. had breached its obligations to Blue Gold under the Exploration Agreement by failing to secure an outside participant for the full term of the joint venture, and by failing to meet its minimum expenditure obligations for the 1988 calendar year. He also addressed the question of whether W.W.S. had fiduciary obligations to Blue Gold, and noted on page 255 that:

> Perhaps the most objectionable matter with regard to the [Undisclosed Conwest Agreement] which bears repetition is the fact that the Defendants had, in April 1988 and thereafter, expressed a desire to get a prospect or play in the Bigstone Area in Alberta where successful wells were drilled in 1987. Mr. Matchett was well aware of the interest of the Defendants in this area and while Mr. Matchett did not promise the Defendants he or W.W.S. could get them a play in the Bigstone Area, he stated it was "possible" and this was the proverbial carrot that, at least in part, induced the Defendants to enter into the [Exploration Agreement]...
>
> The Defendants at no time prior to February 1989 had any reason to suspect that they were in competition with their two 49% participants for funds, prospects and plays, nor that they were the 100% participants in another venture.

Mr. Matchett opined that W.W.S. was not in breach of either its contractual or fiduciary duties to Blue Gold under the Exploration Agreement due to the fact that the interests acquired by W.W.S. under the Undisclosed Conwest Agreement were excepted from the application of the Exploration Agreement by a conflict of interest clause in the Exploration Agreement. Among other things, this clause expressly relieved W.W.S. of any obligation to present Blue Gold with any play for which the interest available to Blue Gold was 10% or less, and W.W.S. argued that since it only retained a 10% interest in plays generated by it under the Undisclosed Conwest Agreement, it had no obligation to present any such plays to Blue Gold. After reviewing the subject clause Prowse J. concluded that the 10% exemption contained therein was not applicable, noting that the clause also expressly prohibited W.W.S. from undertaking any other "Exploration Joint Ventures" during the term of the Exploration Agreement, and opining as well that W.W.S.'s interest in plays generated under the Disclosed Conwest Agreement was "not limited to 10%." He accordingly held that W.W.S. had breached its contractual obligations to Blue Gold by entering into the Undisclosed Conwest Agreement, and also concluded at page 257 that:

> I further find that W.W.S., in acting under the [Exploration Agreement], owed fiduciary duties to the Defendants which included the duty to act *bona fide* and the duty to make full disclosure. I am of the opinion that if the interest acquired by W.W.S. pursuant to [the Undisclosed Conwest Agreement] is within the exemption referred to in [the conflict of interest provision], W.W.S. is nevertheless in breach of the fiduciary duties of good faith and full disclosure.

Prowse J. accordingly dismissed the claim of W.W.S. as against Blue Gold and allowed the counterclaim.

With respect to Mr. Matchett's claim, Prowse J. noted that although Blue Gold did not know about the Undisclosed Conwest Agreement (which had been orchestrated by Mr. Matchett) at the time of Blue Gold's termination of the Consulting Agreement, it had

"come to the conclusion" that Mr. Matchett had breached his obligation under the Consulting Agreement to "bring prospects to [Blue Gold] which do not fall within the parameters of the [Exploration] Agreement." Prowse J. went on to say, at page 258, that:

> In my opinion, it is now academic whether or not knowledge and complaints which the defendants had on 19th January 1989 about Mr. Matchett's performance of the consulting agreement were material defaults justifying termination; their subsequent knowledge of [the Undisclosed Conwest Agreement] clearly justified the termination of the consulting agreement.

Prowse J. accordingly concluded that Mr. Matchett had breached the Consulting Agreement, and dismissed his claim and allowed the counterclaim.

The authors have been advised that an appeal of this decision has been filed.

E. *Trilogy Resource Corp.* v. *Dome Petroleum Ltd.*[87]

In 1977 a West German investor ("Ada") entered into an oil and gas acquisition and development participation agreement (the "Ada Agreement") with Dome Petroleum Ltd. Dome operated the properties acquired under the Ada Agreement (the "Ada Lands"), and in 1978 Dome entered into a reserves based gas purchase contract with TransCanada Pipelines Limited ("TCPL"). All of Ada's interests in the subject lands were dedicated to the performance of the seller's obligations under the TCPL contract.

By agreement made effective October 1, 1979 (the "1979 Agreement") Ada granted Dome a net profits interest in respect of certain of the Ada Lands. In return, Dome undertook to produce a prescribed share of the gas nomination under the TCPL contract from Ada Lands not covered by the net profits interest (the "Retained Lands"). Dome also agreed to continue using its best efforts to operate the Retained Lands so as to optimize their economic return.

As a result of two sale transactions occurring in 1980 and 1981, a corporate predecessor of Trilogy Resources Corporation ("Trilogy") acquired all of Ada's interests in the Retained Lands. Trilogy subsequently commenced this action claiming that Dome had breached its contractual obligations to produce gas from the Retained Lands as required by the 1979 Agreement, and that Dome was also in breach of a fiduciary duty owing as a result of the "special relationship that it had with Ada." In reply Dome contended that Trilogy had no rights under the 1979 Agreement, and that, in any event, Dome had complied with its obligations under the 1979 Agreement and had not breached any fiduciary duty.

With respect to the question of Trilogy's status under the 1979 Agreement, Medhurst J. referred to the "absolute assignment" provisions of s. 21 of the *Judicature Act*, noted that a consent letter obtained from Dome in conjunction with Trilogy's corporate predecessor's acquisition of Ada's interests in the Retained Lands contained an undertaking on the part

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87. (1990), 76 Alta L.R. (2d) 140 (Alta. Q.B.).

of the transferee to be bound by the Ada Agreement and all agreements emanating therefrom, noted that the subsequent course of conduct of the parties evidenced an intention to substitute Trilogy's corporate predecessor for Ada in the 1979 Agreement, and concluded that there had been a novation of the 1979 Agreement, and that Trilogy accordingly had status to bring the action.

With respect to the question of its failure to produce the prescribed volumes of gas from the Retained Lands, Dome noted, among other things, that to have done so would have been economically inefficient having regard to the overall production profile of all of the lands dedicated to the TCPL contract, and that it was simply attempting to act as a prudent operator on behalf of all of the working interest owners involved with the TCPL contract. Medhurst J. nonetheless found that Dome had failed both to produce the share of gas which it had undertaken to produce from the Retained Lands, and to operate the Retained Lands so as to optimize their economic return. Medhurst J. concluded that this failure on the part of Dome constituted a breach of its contractual obligation, and that Dome was therefore liable in damages.

With respect to the question of Dome's fiduciary obligation to Trilogy, Medhurst J. concluded that the breadth of Dome's control in the circumstances "created a situation where Dome was in a fiduciary relationship to Ada (and its successors) to ensure that Ada's interests were at all times properly protected and utilized in the best possible manner." He did not, however, go on to find that Dome's actions constituted a breach of its fiduciary obligations. The finding of liability on Dome's part was based only on a breach of specific contractual obligations. As such, the obligation upon Dome to optimize the economic return of the properties was contractual and the Court is here not saying that an operator, as a fiduciary of the joint-operators, has an obligation to market the joint-operators' share of production.

F. *Bricore Land Group Ltd.* v. *Mohawk Oil Co. Ltd. et al.*[88]

Bricore Land Group Ltd. applied for an order cancelling and discharging a caveat filed by Mohawk Oil Co. Ltd. pursuant to s. 160(1) of the Saskatchewan *Land Titles Act*,[89] which provides in part that:

> 160(1) Any owner or other person claiming an interest in land against which a caveat has been registered for the protection of a building restriction affecting the land or the use thereof, however created, may apply to a judge, who, after such notice and hearing as he may deem proper and upon such terms and conditions as he may fix, may vary, cancel or substitute in whole or in part such building restriction and discharge or vary the caveat.

Mohawk sold certain property on terms under which the purchasers granted Mohawk a restrictive covenant which restricted the purchasers from involvement in the retail or wholesale sale of petroleum products on or from the property. Mohawk filed a caveat

88. (1990), 86 Sask. R. 179 (Sask. Q.B.).
89. R.S.S. 1978, c. L-5.

against the property based on this restrictive covenant. The property was then transferred to an individual purchaser who subsequently entered into an agreement with Bricore for the sale of the property (the "Offer"). The Offer was made subject to two conditions, those being the removal of the Mohawk caveat and Bricore obtaining financing.

Among other things, Mohawk submitted that Bricore lacked the status and standing to bring the application under s. 160 because the Offer did not provide it with an interest in the property. It was Mohawk's contention that, as a result of the conditions contained in the Offer, there was no binding contract between the parties until the conditions had been satisfied. In responding to this contention, Maurice J. stated, at page 181, that:

> There is authority to the effect that even where there is a condition precedent, a binding contract exists between the parties; although the obligations of the parties under it are suspended until the condition precedent is satisfied.

Maurice J. went on to say that:

> Whether a condition is a condition precedent or a condition subsequent depends on the intention of the parties at the time they made their agreement. There is nothing in the [Offer] to indicate it was the intention of the parties that satisfaction of the conditions would be required before there would be a binding contract between them. On the contrary, it is obvious the conditions in question were put into the contract for the benefit of the purchaser, which could waive them if it so desired. The [Offer] was meant to be a binding contract that obligated the vendor to sell and that obligated the purchaser to buy, provided the conditions of performance were satisfied or the purchaser waived them.

Accordingly, Maurice J. concluded that upon execution of the Offer a binding contract came into existence, giving Bricore an interest in the property.

It should be noted that Maurice J.'s test of the intention of the parties as being determinative of the issue of whether a condition is a condition precedent or a condition subsequent is only one of a number of different ways in which the test with respect to this issue has been expressed. By way of example, in *Turney* v. *Zhilka*[90] Judson J., delivering the judgment of the Supreme Court of Canada, stated at page 583:

> The obligations under the contract, on both sides, depend upon a future uncertain event, the happening of which depends entirely on the will of a third party - the village council. This is a true condition precedent - an external condition upon which the existence of the obligation depends. Until the event occurs there is no right to performance on either side. The parties have not promised that it will occur.

As such, another means of describing the test is that a true condition precedent makes the existence and validity of the contract conditional upon the happening of some event beyond the control of the parties to the contract. There is also reference in the authorities that a true condition precedent can never be unilaterally waived, whereas a condition subsequent can be waived by the party for whose benefit such condition has been

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90. [1959] S.C.R. 578.

introduced into the contract. Maurice J. did allude to this consideration in his reasons as evidence of the intention of the parties.

G. *United Canso Oil & Gas Ltd.* v. *Washoe Northern Inc.*[91]

In this case United Canso Oil & Gas Ltd. wished to call Dr. Andrew R. Thompson as an expert witness, to give opinion evidence as to:

(a) the meaning of a carried interest;

(b) the terms found in carried interest agreements;

(c) widely accepted underlying assumptions relating to carried interest agreements; and

(d) whether any of three conveyancing agreements (which were at issue in this case) could be categorized as carried interest agreements.

The defendants wished to call the solicitor who had drafted two of the three conveyancing agreements as a witness to give evidence as to his knowledge of the structure of the subject transactions.

In permitting both witnesses to testify with certain restrictions, Hutchinson J. made reference to a number of cases dealing with the parol evidence rule and opinion evidence, including *Alpine Resources Ltd.* v. *Bowtex Resources Ltd.*,[92] wherein Virtue J. states at page 147:

> The question as to the use to be made of extrinsic evidence in the interpretation of a written contract has been thoroughly canvassed by the Courts of Queen's Bench and Appeal in this province, and I do not propose to analyze the case law further other than to mention two cases which have particular application to this case. The conclusion I reach from the authorities is that, generally speaking, when a contract has been reduced to writing, verbal or written evidence cannot be relied upon so as to add to or subtract from, or in any manner to vary or qualify the written contract. It is however permissable, even where there is no ambiguity, to have regard to extrinsic evidence to discover the intention of the parties by interpreting the words of the contract in light of the circumstances in which they were used. The court can look to the history of the transaction and to the commercial setting in which the contract evolved, in order to discover the real intention of the parties from the words used in the agreement. While the court cannot change the words of a contract, it can, if the circumstances require, give those words a broad or loose interpretation (rather than a strict or narrow one) so as to achieve, if possible, the commercial aim and purpose of the parties.

Having regard to the foregoing, Hutchinson J. was of the view that Dr. Thompson could not be asked to interpret the conveyance agreements or to determine whether the

91. (1991), 78 Alta. L.R. (2d) 79 (Alta. Q.B.).
92. (1989), 66 Alta. L.R. (2d) 144 (Alta. Q.B.).

same constituted carried interest agreements. However, the Court was prepared to permit Dr. Thompson to express his opinion concerning the usual or widely held underlying assumptions relating to carried interest agreements. This evidence was to be used as an aid to interpretation. Further, Dr. Thompson would be permitted to express an expert opinion as to the meaning of a carried interest and the terms to be found in carried interest agreements.

Similarly, the solicitor who drafted two of the conveyance agreements could be questioned on his knowledge of the commercial purpose of the contracts, the genesis of the transaction, the background, the context, the market in which the parties were operating and the business objectives of the transaction. Counsel could not, however, be asked to give evidence concerning the negotiations which may have taken place giving rise to the final agreements, nor could he be asked to give any personal opinion concerning the meaning of any particular clause in the agreements.

H. *Doolaege* v. *Solid Resources Ltd.*[93]

Porta-Test Inc. entered into an agreement with Baker Oil Tool to buy Baker's business for $900,000. In conjunction therewith Camiel Doolaege agreed to lend Porta-Test $200,000, and did so pursuant to the terms of a loan agreement entered into between Port-Test and Doolaege. Subsequent to acquiring Baker's business, Porta-Test sold part of its business operations to Solid Resources Ltd., and Doolaege, Porta-Test and Solid Resources entered into an agreement which provided in part that:

> The undersigned parties hereby acknowledge and agree that the sum of Two Hundred Thousand Dollars ($200,000) due and owing by Porta-Test Inc. to Camiel Doolaege as of the date hereof is hereby assumed by Solid Resources Ltd. (formerly Hartz Equities Inc.) and assigned by Porta-Test Inc., effective June 21, 1988.
>
> The undersigned further acknowledge and agree that effective as of June 21, 1988 that Solid Resources Ltd. is now indebted to Camiel Doolaege in the amount of Two Hundred Thousand Dollars ($200,000), and agrees to pay all interest owing in respect thereof.
>
> Camiel Doolaege hereby acknowledges and consents to the said assignment by Porta-Test Inc. and the assumption by Solid Resources Ltd. of the Two Hundred Thousand Dollars ($200,000) owing by Solid Resources Ltd. to Camiel Doolaege, and agrees to release Porta-Test Inc. of any liability for the said indebtedness effective as of June 21, 1988.

This agreement was executed by Doolaege and Solid Resources but not by Porta-Test.

Solid Resources complied with the terms of the loan arrangement for a period of time, but in September, 1989 ceased making payments, and Doolaege commenced an action on the debt. Solid Resources' defence was premised on the purchase agreement entered into between itself and Porta-Test. Master Funduk addressed Solid Resources' defence (the

93. (1990), 108 A.R. 52 (Alta. Q.B.).

particulars of which are not relevant for the purposes of this discussion) in the following fashion at page 56:

> Solid Resources has missed the point both in its pleading and its evidence.
>
> Doolaege does not and cannot have a cause of action against Solid Resources based on the Purchase Agreement.
>
> Doolaege had an agreement with Porta-Test, being the loan agreement. Without more, his cause of action in debt would be against Porta-Test based on the loan agreement.
>
> However, if that loan agreement was replaced by another agreement any cause of action would be based on the replacing agreement.

Master Funduk then observed that the replacing agreement would have to meet the test for a novation and made reference to the decision of the Alberta Court of Appeal in *Collingwood Investments Ltd.* v. *Bank of America Canada Mortgage Corp.*,[94] wherein the Court states at page 8:

> I am of the opinion that the renewal agreement does not effect a novation. The requirements of novation were recently discussed in *Paramount Life Ins. Co.* v. *Torgerson Dev. Corp. (Alta.) Ltd.* (1987), 51 Alta. L.R. (2d) 59 by Forsyth, J. at p. 63:
>
>> It is well established that the three basic principles that are legally required to create a novation are:
>>
>> (1) the new debtor must assume total liability;
>>
>> (2) the creditor must accept the new debtor as a principal debtor and not merely as agent or guarantor;
>>
>> (3) the creditor must accept the new contract in full satisfaction and in substitution for the old contract.
>
> A fourth requirement, namely, that the new contract must be made with the consent of the old debtor, is occasionally cited.

In this particular instance, and in finding in favour of Doolaege, Master Funduk stated at page 58 that:

> I am satisfied that the requirements for a novation as set out in *Collingwood Investments* have been met. Solid Resources assumed total liability for the debt. Doolaege accepted Solid Resources as a principal. Doolaege accepted the new agreement in full satisfaction and in substitution for the loan agreement

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94. (1988), 58 Alta. L.R. (2d) 1 (Alta. C.A.).

> between him and Porta-Test. Doolaege released Porta-Test for any liability for the debt, which clearly establishes the third requirement.

Master Funduk also concluded that Porta-Test's failure to execute the document did not mean that there was no novation, noting that it is not the law that a novation must be in writing or signed by the creditor, the old debtor, and the new debtor and that a novation can be oral or partly oral and partly written or totally written. All that is necessary is that on the evidence the court is satisfied that there is a novation.

I. *Guaranty Trust Co. of Canada* v. *Hetherington*[95]

There has been significant "fall-out" from the Court of Appeal's decision in *Guaranty Trust Company of Alberta (sic)* v. *Hetherington.*[96] The Court found in that case that the royalty trust agreements at issue, properly construed, applied only to the leases in existence when the agreements were executed. The recitals expressly referred to the specific lease, and it was the royalty payments thereunder which were assigned. The trial judge had construed the "cancellation" clause as showing contemplation of subsequent leases, but that clause was more restrictively interpreted by the Court of Appeal (i.e., a lease acquired after a surrender of the first lease would be covered, but one following a termination or expiry would not). The Court of Appeal did not address the question of whether the royalty trust agreements under consideration created an interest in land.

The results of the *Hetherington* decision were received by many in the oil and gas industry with surprise, because of an assumption that royalty trust agreements created an interest in land and extended to subsequent leases. As a result of the *Hetherington* decision, the courts have been required to manage what could potentially be a large number of proceedings to determine the validity of numerous royalty trust agreements, in the context of a variety of fact situations. There are two types of proceedings, the first involving substantially the same facts and form of agreement as in the *Hetherington* case, and the second involving facts or agreements which are distinguishable.

Where the form of the royalty trust agreement is the same as the one considered in *Hetherington* and production did not occur under the original lease, the court has generally granted the mineral owner an order declaring the royalty trust agreement to have expired. The order is then served on unitholders, who must commence proceedings within limited periods of time if they wish to assert the continued validity of the agreement. A number of unitholders appear to be deciding not to proceed, due to similarities to *Hetherington*, in return for a release from the landowner of a claim for the return of past moneys received. There may be an issue as to whether the trustee, the lessee, or the unitholders are liable to the landowner for such payments. In these cases, it is generally considered necessary to find a factual basis to distinguish *Hetherington*, such as a direction to pay

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95. (1989), 67 Alta. L.R. (2d) 290 (Alta. C.A.) [hereinafter "*Heatherington*"].

96. (1989), 67 Alta. L.R. (2d) 290 (C.A.). For a summary of this decision and the earlier trial judgment of O'Leary J., *Guaranty Trust Company of Canada* v. *Hetherington* (1987), 50 Alta. L.R. (2d) 193 (Q.B.), see Robert P. Desbarats, "Recent Judicial Decisions of Interest to Oil and Gas Lawyers" (1990), 28 Alta. L.R. 254 at 265-67.

by the mineral owner authorizing continued royalty payments to the trust company despite a subsequent lease.

Other actions are proceeding to determine whether any or all royalty trust agreements create interests in land, thus binding subsequent owners of the mineral interests, and whether different forms of royalty trust agreements than the one considered in *Hetherington* should be construed to apply to leases subsequent to the one in effect at the time the royalty trust agreement was made. Central Guaranty Trust Company is the trustee for the largest number of royalty trust agreements. To manage the large number of cases involving its agreements, test cases are proceeding pursuant to an order given by Mason J., with counsel appointed to protect the interests of unitholders and the interests of mineral owners. All cases with similar facts to those of the test cases are being held in abeyance pending the decisions in the test cases. One type of test case involves consideration of a form similar to the one in *Hetherington*, but where production occurred under the original lease; the primary issue is whether an interest in land was created by the royalty trust agreement. The other cases involve different forms of agreements, which on their terms may be construed to apply to subsequent leases. In those cases, the court is also asked to determine whether an interest in land is created. There are also proceedings involving other trust companies, which may result in test cases, or more informal arrangements by which some parties await the outcome of cases involving larger interests.

While these actions are proceeding, trust companies have been seeking court orders authorizing amounts which would otherwise be payable to unitholders to be paid into court. Some lessees have been seeking similar types of orders, whereby royalties are paid into court rather than to the trustee under the royalty trust agreement.

VII. SURFACE RIGHTS

A. *Sandboe et al.* v. *Coseka Resources Ltd. (No. 2)*[97]

This case was first reported in the 1989 paper,[98] wherein it was noted that the matter under consideration had been returned to the Alberta Court of Queen's Bench for a new trial because of a reasonable apprehension of bias on the part of the original trial judge. The facts of this case are that the Alberta Surface Rights Board, following a hearing on July 11, 1985, granted a right of entry order and prescribed the compensation to be paid to the owners for a well-site and access road. The owners appealed and the operator cross-appealed the amount of compensation. The owners abandoned their appeal before it was heard, which left the operator's cross-appeal to be heard, the only issue being the amount of compensation payable. Other relevant facts are that the operator released the rig on July 15, 1985, the well was abandoned as a dry hole on August 9, 1985, a surface reclamation certificate was issued on August 12, 1986 and a termination order was granted by the Surface Rights Board on April 27, 1987.

97. (1990), 108 A.R. 226 (Alta. Q.B.).

98. See R.P. Desbarats, "Recent Judicial Decisions of Interest to Oil and Gas Lawyers" (1990) 28 Alta L.R. 254 at 293.

The owner's position was that the only evidence which should be heard in the matter was the evidence that was before the Surface Rights Board on July 11, 1985. The operator argued that, because of the events that occurred subsequent to July 11, 1985 (i.e., the abandonment of the well), the loss of use factor, the adverse effect factor and the weed control factor should all be reduced, both in the compensation for the first year and in the annual compensation to the date of the termination order. The operator further contended that because the owners regained possession of their land very quickly and without permanent damage, a credit should be given to the operator. In responding to these submissions Andrekson J. stated at page 228:

> It is clear that the Act contemplates that the amount of compensation payable be determined as of the date that the Right of Entry order was made, i.e. 11 July 1985. It is my view that events that occurred after the 11 July 1985 hearing of the Board should not be considered on appeal. The advantages or disadvantages of evidence of subsequent events should not in my view be utilized to vary the Board's decision.

Andrekson J. continued at page 232:

> It is my view that a Board is obliged to make its findings based on the evidence before it when considering to grant the right of entry to the operator. Those findings may be imprecise in hindsight, but to proceed in any other way would always necessitate an appeal in every case to consider new evidence in the light of subsequent events.

Accordingly, Andrekson J. confirmed the award made by the Surface Rights Board and dismissed the cross-appeal.

B. *Woronuk* v. *Alberta Power Ltd.*[99]

The Alberta Surface Rights Board awarded compensation to Mr. Woronuk on the basis of an appraisal offered by Alberta Power Ltd., and Mr. Woronuk appealed the Board's award. Bracco J. of the Alberta Court of Queen's Bench accepted Mr. Woronuk's arguments and concluded that the Surface Rights Board had erred in accepting Alberta Power's appraisal. Bracco J. went on to accept another appraisal, one that had been earlier rejected by the Surface Rights Board, and stated:

> I find that Mr. Grose's evaluation was based on valid and suitable comparable data regarding sales of small parcels close to the subject land in both location and time. I find that Mr. Grose's evaluation at $16,500 per acre is both sound and reasonable.

The decision of Bracco J. was appealed, and Kerans J.A., for the Court of Appeal, concluded that Bracco J. had erred in accepting Mr. Grose's evaluation as it was obvious to the Court of Appeal that certain adjustments had to be made to the Grose appraisal. Kerans J.A. stated that:

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99. (September 11, 1990) Appeal No. 19122 (Alta. C.A.).

> Our difficulty is that Mr. Grose, by his own admission, did not factor into his appraisal what we consider to be obvious factors that might give rise to an adjustment: existing zoning, configuration, location and timing. All of these were of critical importance in this case. Some of the "comparables" were already zoned for commercial development; some were already inside the town; some were adjacent to highways; and some were taken before 1983. The lands taken, by comparison, were outside the town, zoned for agricultural use, strangely configured, in part not adjacent to a highway, and taken in two stages; one parcel in 1983 and another in 1985 (all in a rapidly changing market).

The Court of Appeal went on to conclude that it was a reviewable error for Bracco J. to fail make such adjustments to the Grose appraisal, and a new trial on all heads of compensation was directed.

C. *Chevron Canada Resources Ltd.* v. *Gabrielle*[100]

Gabrielle applied to the Surface Rights Board of Manitoba for a change in the compensation to be paid by Chevron Canada Resources Ltd. for three separate well-sites. The original well-site leases were freely negotiated and entered into in 1985, the annual compensation thereunder being $1,652, $1,716 and $1,029 respectively. Gabrielle sought $2,300 per annum per well-site, and the Surface Rights Board awarded him $2,200 per well-site. Chevron sought leave of the Manitoba Court of Appeal to appeal the orders alleging, among other matters, that the Surface Rights Board had failed to observe a principle of natural justice in relying on evidence acquired by it prior to the hearing as to the market rate being paid by various oil companies in Manitoba, Saskatchewan and Alberta.

The Manitoba Court of Appeal denied leave to appeal,[101] stating that the issue of whether or not the Surface Rights Board had the right to rely on knowledge acquired prior to the hearing in reaching its decision was an "arguable point of law," and noting, at page 74:

> It is not reasonable to expect that any Board member comes to any hearing divorced from that prior acquired knowledge. It is, in fact, his or her individual expertise which qualifies an individual as a Board member.

The Manitoba Court of Appeal concluded, however, that even if the Surface Rights Board was not entitled to rely on prior knowledge, the evidence did not substantiate any error committed by the Surface Rights Board in this regard. Chevron appealed the refusal of the Manitoba Court of Appeal to grant leave. In dismissing this appeal, Twaddle J. states, at page 231:

> The purpose of requiring that leave be first obtained is not merely to ensure that a point of law, of jurisdiction or of natural justice is raised. It is to ensure that the issue is one which, in all the circumstances of the case, is a proper one for the consideration of the court. It is the responsibility of

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100. (1990), 68 Man. L.R. (2d) 230 (Man. C.A.).
101. (1990), 65 Man. L.R. (2d) 71.

> the judge hearing the leave application to determine whether there is an issue and, absent a clear error by the learned judge in Chambers on a matter of essential principle, this court will not entertain an appeal from an order refusing leave.

Twaddle J. went on to conclude that none of Chevron's grounds for appeal involved an error in a matter of essential principle and that this was sufficient grounds upon which to dismiss the appeal.

VIII. LAND TITLES

A. *Green Drop Ltd.* v. *Schwormstede*[102]

The Court of Queen's Bench decision in this matter was reported in last year's paper.[103] The facts are that the husband owned a quarter section of land which was a homestead within the meaning of the *Dower Act*.[104] Green Drop Ltd. was interested in acquiring a nine acre parcel out of this land, but, Mrs. Schwormstede objected and would not release her dower rights. Green Drop, acting in the name of the husband, took all steps necessary to subdivide out the nine acre parcel, and was ultimately successful in registering the subdivision. In the interim, however, Mrs. Schwormstede had filed a caveat claiming dower rights, and when the transfer of the subdivided parcel was effected as between Mr. Schwormstede and Green Drop, Green Drop took title subject to the referenced caveat. At the Queen's Bench level Deyell J. granted an order vacating the subject caveat, and Mrs. Schwormstede appealed that decision.

Deyell J. had concluded that a dower homestead ceases to exist upon transfer of it by the married owner. Accordingly, no dower rights were applicable to the subdivided parcel after the transfer to Green Drop, and Mrs. Schwormstede therefore had no interest to support her caveat. The Alberta Court of Appeal reached a contrary conclusion, noting at page 145 that:

> We asked counsel for the transferee why the caveat could now be ignored. The answer, consistent with the trial judge's judgment, was that the homestead ceases to be a homestead under the *Dower Act* when the transfer was registered and therefore there was nothing left for the caveat to protect. We doubt the point was put this way before the chambers judge. He, like us, would, no doubt, have been somewhat surprised at the proposition that a dower caveat, protecting a right which includes the right to prohibit disposition without consent, ceases to be effective when disposition without consent occurs.

The Court of Appeal concluded that the *Dower Act* had to be read in conjunction with the *Land Titles Act*,[105] and made specific reference to s. 135 of the *Land Titles Act*, which provides that:

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102. (1990), 106 A.R. 143 (Alta. C.A.).
103. *Supra*, note 21 at 211.
104. R.S.A. 1980, c. D-38.
105. *Supra*, note 33.

> 135. So long as a caveat remains in force an instrument registered subsequent to the caveat and purporting to effect the land, mortgage or encumbrance in respect of which the caveat is lodged is subject to the claim of the caveator.

The Court continued at page 145:

> The consequence is that one must read the *Dower Act* as saying that the homestead ceases to exist (and a right in damages accrues) when an unimpeachable transfer is registered. The *Land Titles Act* makes this an impeachable transfer. We were treated to a consideration of the history of the *Dower Act* and we simply say that the Act, consistent with the case authority, recognizes that a prohibited disposition is ineffective unless the land titles law makes it effective. Here, land titles law does not make it effective - to the contrary - that law makes the disposition ineffective.
>
> A caveat protecting an interest unquestionably and undeniably in existence prior to subdivision and transfer must continue to subsist against the transferee who takes subject to that caveat. To hold otherwise would work serious harm to the operation of both the *Land Titles Act* and the *Dower Act*.

As a result, the appeal was allowed and the application to have the caveat discharged from title failed. Of note in this case is that counsel for Green Drop argued that a subdivision automatically produces a smaller homestead since "homestead" is defined by the *Dower Act* as being "a parcel of land." The argument continued that Mrs. Schwormstede's dower rights survived only as against this diminished parcel, and that any and all subdivisions lawfully carried out by Mr. Schwormstede diminished Mrs. Schwormstede's dower rights. The Alberta Court of Appeal stated at page 146 that:

> If this argument is correct, then a subdivision is, surely, a "disposition" within the meaning of the *Dower Act*.

We would have to suggest that the Court of Appeal's characterization of a subdivision (i.e., husband to husband) as being a disposition for the purposes of the *Dower Act* is artificial (a fact which was admitted by the Court) and constitutes a very liberal interpretation of the s. 1(c) definition of "disposition."

From Green Drop's perspective, the present risk is that Mr. Schwormstede predeceases Mrs. Schwormstede, in which event Mrs. Schwormstede would have a life interest in and to the subject lands and could therefore take possession of the property. Obviously, what Mrs. Schwormstede would like to do is simply demand enormous rent from Green Drop.

The authors have been advised that counsel for Mrs. Schwormstede recently made application for an order compelling Green Drop to transfer the nine acre subdivided parcel back to Mr. Schwormstede on the basis that the transfer after the subdivision was void. The authors have also been advised that counsel was unsuccessful in this application. Evidently, the reason for dismissing the application was that the Court of Appeal had stopped short of concluding that the transfer to Green Drop was void, holding only that the same was impeachable and ineffective. It would seem that what was meant by the Court of Appeal was that the transfer was ineffective insofar as extinguishing

Mrs. Schwormstede's dower rights but effective as between Mr. Schwormstede and Green Drop.

B. *White Resource Mgmt. Ltd.* v. *Durish*[106]

A very skeletal summary of the relevant facts in this case,[107] in chronological order, is as follows:

(a) May 10, 1968 - By agreement of purchase and sale Leonard Carlson, then the registered owner of the subject freehold mines and minerals estate (the "Lands"), agreed to sell the same to Ralph Vold.

(b) November 5, 1969 - Vold registered a caveat with respect to the May 10, 1968 agreement of purchase and sale against title to the Lands (the "Vold Caveat").

(c) November 25, 1971 - With the written consent of all estate beneficiaries, the executrix of the Carlson estate granted a petroleum and natural gas lease in respect of the Lands to Pawnee Petroleums Ltd. (the "Pawnee Lease").

(d) March 14, 1973 - Pawnee assigned its interest in the Pawnee Lease to Brascan Resources Ltd.

(e) August 31, 1976 - Brascan assigned its interest in the Pawnee Lease to Haida Resources Ltd.

(f) October 1, 1976 - Haida registered a caveat in respect of its interest in the Pawnee Lease against title to the Lands (the "Haida Caveat").

(g) March 7, 1978 - As a result of a failure by Vold to respond to a notice to prove, the Vold Caveat lapsed and was discharged.

(h) May 27, 1978 - Vold granted a petroleum and natural gas lease in respect of the Lands to White Resource Management Ltd. (the "Vold Lease").

(i) June 13, 1978 - White Resource Management registered a caveat in respect of the Vold Lease against title to the Lands.

(j) May 24, 1979 - Haida assigned its interest in the Pawnee Lease to Victor Durish.

(k) December, 1979 - A producing gas well was drilled on the Lands by a third party under an option arrangement with White Resource Management.

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106. (1991), 77 Alta. L.R. (2d) 131 (Alta. Q.B.).

107. For a related proceeding see *supra*, note 98 at 267.

White Resource Management commenced this action to obtain a declaration of its entitlement to the petroleum and natural gas rights in and to the Lands under and by virtue of the Vold Lease, and ancillary to this issue was the question of entitlement to the revenues from the gas well, estimated to be in the amount of $937,007.79. Durish defended and counterclaimed, alleging that the Pawnee Lease assigned through Brascan and Haida to him, and protected by the Haida Caveat, took priority over any interest held by White Resource Management.

Counsel for Durish argued that under s. 195 of the *Land Titles Act* [108] the Haida Caveat took priority on the register when the Vold Caveat was discharged, and that by acquiring Haida's caveated interest Durish obtained that priority position, and accordingly had priority over all unregistered or later registered interests. Section 195 provides that:

> 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 or to see to the application of the purchase money or of any part thereof, nor is he affected by notice direct, implied or constructive, of any trust or unregistered interest in land, any rule of law or equity to the contrary notwithstanding, and the knowledge that any trust or unregistered interest is in existence shall not of itself be imputed as fraud.

Counsel for Durish cited the Supreme Court of Canada decision in *Union Bank of Canada* v. *Boulter Waugh Ltd.*[109] as authority for this position. In the *Boulter Waugh* case, the bank obtained a mortgage from the registered owner and took this mortgage subject to a caveat filed by an equitable mortgagee. The caveat of the equitable mortgagee lapsed and the Supreme Court of Canada held that despite the fact that the bank had knowledge of the equitable mortgagee's prior interest, the bank had priority with respect to its mortgage. On the basis of *Boulter Waugh*, counsel for Durish made the argument previously alluded to. Mason J., however, while "[a]ccepting for the sake of argument ... there was no fraud on the part of Durish," concluded that there were "several reasons" why Durish could not rely on the *Boulter Waugh* decision in this case.

The first reason given by Mason J. for distinguishing *Boulter Waugh* was that, "[o]n its wording, s. 195 is designed to apply only to transactions between the registered owner and bona fide third party purchasers." Since Durish acquired the Pawnee Lease rights from a caveator, and not the "registered owner" of the lands, he was not entitled to rely on the provisions of s. 195.

The second reason for distinguishment given by Mason J. was that the lapsing of the Vold Caveat did not "destroy the privity of estate" between Vold and the owners of the fee simply estate in the lands, or between Vold and Pawnee, "whose interest in the petroleum and natural gas rights was acquired with the full knowledge of Vold's

108. *Supra*, note 33.
109. (1919), 58 S.C.R. 385 [hereinafter "*Boulter Waugh*"].

registered interest as Vold's caveat was in full force at the time Pawnee acquired that interest."

The third reason for distinguishment given by Mason J. was that "Durish could obtain no better position on the title to the mines and minerals than that obtained by Pawnee at the time it acquired its interest."

Mason J. relied on the Saskatchewan Court of Appeal decision in *Bensette* v. *Reece*,[110] and the Alberta Court of Appeal decision in *Passburg Petroleums Ltd.* v. *Landstrom Dev. Ltd.*,[111] as authority for his conclusions, finding on the basis thereof that White Resource Management's interest in land under and by virtue of the Vold Lease existed independent of the register and that White Resource Management's interest would be recognized and given validity as against Durish's competing claim unless Durish had relied upon the register in obtaining his interest. As noted by Mason J. at page 147:

> In this case Pawnee obtained [the Pawnee Lease], 25th November 1971, from the executrix of the Carlson estate before she was so registered on the certificate of title. However, she was in fact the legal representative of the Carlson estate. At that time, Pawnee relied on the register and in those circumstances it obtained its interest subject to the equitable interests of Vold, under his agreement for sale with Carlson, as protected by [the Vold Caveat]....
>
> Through the assignments of Pawnee to Brascan and then to Haida as of 31st August 1976, the register did not change. Therefore, when Haida filed [the Haida Caveat] on 1st October 1976 it did so subject to Vold's interest on the register, and, as well, the estate obtained by Haida from Pawnee through Brascan was also subject to the Vold caveated interest.
>
> Neither Brascan, Haida nor Durish relied upon the register in their respective assignments of the [Pawnee Lease], one to the other. None of them dealt with the registered owner as a *bona fide* third party purchaser. The assignment of the Pawnee interest conveyed nothing more or less than Pawnee could ever have conveyed as an immediate party to the transaction between it and the executrix of the Carlson estate at which time the title was subject to Vold's caveated interest.

On this basis Mason J. concluded that Haida's position under the Pawnee Lease was not changed or improved by the lapse of the Vold Caveat, and that by not filing another caveat Vold would only have lost priority vis-à-vis a *bona fide* third party purchaser who might have dealt with the registered owners subsequent to the lapse of the Vold Caveat. By claiming its interest through Vold, White Resources Management obtained priority with respect to the petroleum and natural gas rights over the Pawnee Lease and Haida's position thereunder. As a result, Durish's claim under the Pawnee Lease was subject to the prior claim which White Resource Management had under the Vold Lease.

With respect to Mason J.'s first basis for distinguishing *Boulter Waugh*, presumably if Pawnee had not assigned the Pawnee Lease and had brought this application, dealing as

110. [1973] 2 W.W.R. 497.
111. [1984] 4 W.W.R. 14.

it did with the registered owner and consistent with *Boulter Waugh*, Pawnee would have been entitled to priority over White Resource Management. In essence, therefore, what the Court is concluding in this instance is that Haida, as an assignee of Pawnee's interests in the Pawnee Lease, could not succeed to the potential of an improved priority position. No reasons are given by the Court for this finding and there is at least a question in the writer's minds as to why Haida could not, as an assignee of Pawnee's rights (including, presumably, Pawnee's rights under s. 195 of the *Land Titles Act)*, could not claim priority over White Resource Management on the basis of the *Boulter Waugh* decision.

It is also of interest to note that the Court states that the lapse of the Vold Caveat did not affect the fact that Pawnee took the Pawnee Lease with full knowledge of Mr. Vold's agreement of purchase and sale and as a caveat does not create rights, similarly the lapse of the Vold Caveat could not have the affect of improving another caveator's priority position. It follows from this assertion and as stated by the Court, by not filing another caveat, Mr. Vold would only have lost priority insofar as any *bona fide* third party who might have dealt with the registered owner subsequent to the lapse of the Vold Caveat. This finding of the Court seems to ignore completely the effects of the *Boulter Waugh* decision.

In short, the writers would have to suggest that because of the factual circumstances in this case (Mr. Durish clearly did not come with clean hands and was arguably motivated by greed), the Court in no way wanted to find in his favour, however, in finding for White Resource Management, the legal bases upon which the Court relies are questionable. It would appear that the difficulty in this case really rests with the decision of the Supreme Court of Canada in *Boulter Waugh* which we would further suggest is bad law.

C. *Amoco Can. Resources Ltd.* v. *Potash Corp. of Sask. Inc.*[112]

Potash Corporation of Saskatchewan was the registered owner of a four-fifths interest in all mines and minerals within, upon or under certain lands, subject to the following exception:

> ...all coal, petroleum, natural gas and all other hydrocarbons, all other gases whether hydrocarbon or not and all other minerals and substances, occurring in association with any of the foregoing in a fluid state.

Amoco Canada Resources Ltd. was the lessee under three leases which granted the following leased substances:

Lease 1

> ..all the petroleum and natural gas and related hydrocarbons except coal and valuable stone...

112. [1990] 5 W.W.R. 641 (Sask. Q.B.).

Leases 2 and 3

> ...the petroleum, natural gas and related hydrocarbons (except coal and valuable stone), all other gases, and all minerals and substances (whether liquid or solid and whether hydrocarbons or not) produced in association with any of the foregoing or found in any water contained in an oil or gas reservoir...

Amoco Canada registered caveats protecting its interests under the subject leases against the mines and minerals titles in question, and the Potash Corporation filed notices to prove on the basis that:

(a) the leased substances granted by Lease 1 fit entirely within the exception to title; and

(b) although the leased substances granted by Leases 2 and 3 are only partially excepted from title, the leased substances which are not excepted do not involve an interest in land.

With respect to Lease 1, Amoco Canada submitted that the language of the exception was not clear and that the phrase "other hydrocarbons" should be restrictively interpreted in light of the preceding words coal, petroleum and natural gas in accordance with the *ejusdem generis* rule of construction, and relied on American authorities in this regard. The argument continued that as all hydrocarbons were not excepted there may be "related hydrocarbons" under Lease 1 which might exist that would not fall entirely within the exception. Scheibel J. responded at page 646:

> American jurisprudence, in particular, abounds in this area with cases in which the courts have applied the *ejusdem generis* rule to construe "other minerals." Two points should be noted. First, the *ejusdem generis* rule is only resorted to if the language is ambiguous.... Second, in all of the cases referred to above, the court was considering whether a specific substance fell within the reservation or exception. The applicant in the case at bar has not alleged any particular substance for the court's consideration. Instead, it submits that it is "conceivable" that a hydrocarbon substance exists that is related to petroleum and natural gas but not of a similar type or kind.
>
> In order to hold that caveat 1 be continued, it is necessary to find that the wording of the exception is ambiguous. In my view the wording is not ambiguous. Moreover, even if the language is ambiguous, the court would also have to find that a phantom "related hydrocarbon" might exist that would not fall entirely within the exception. There is no evidence to support this position. A hypothesis cannot be the basis for filing a caveat.

With respect to Leases 2 and 3, Potash Corporation argued that although certain leased substances (i.e., all solid minerals and substances produced in association with petroleum, natural gas and related hydrocarbons) did not fall within the title exception, such substances did not constitute an interest in land. Without dealing with the issue of whether or not Potash Corporation's position on this point was correct, Scheibel J. stated at page 649:

> An interest in minerals *in situ* is an interest in land which can properly be the subject of a caveat: *Bensette* v. *Reece*, [1973] 2 W.W.R. 497 at 501, 34 D.L.R. (3d) 723 (Sask.C.A.). The lease grants an interest in minerals and substances "produced." The interest only becomes real when the minerals and substances are produced. In fact, the interest is dependant upon production. If no production occurs, no interest exists.

For these reasons Amoco Canada's application to continue the caveats was dismissed. It is of interest to note that "leased substances" are defined as follows in the CAPL 1988 Petroleum and Natural Gas Lease:

> 1(e) "leased substances" means all petroleum, natural gas and related hydrocarbons (except coal), and all materials and substances (except valuable stone), whether liquid, solid or gaseous and whether hydrocarbons or not, *produced in association* with petroleum, natural gas or related hydrocarbons or found in any water contained in any reservoir. [emphasis ours]

Given that the CAPL form of petroleum and natural gas lease is generally accepted to be a "lessee's" lease, one might expect to see in the future an amendment to the s. 1(e) definition so as to ensure that the associated materials and substances are caveatable interests in land in and of themselves.

D. *Canada Cement Lafarge Ltd.* v. *Manitoba*[113]

In this action Canada Cement Lafarge Ltd. sought a declaration with respect to whether or not limestone is a mineral and as such was reserved to the Crown in patents reserving "mines and minerals." Although the issue of whether limestone constitutes a mineral may not on its face be of particular interest to oil and gas practitioners, this case does evidence the common difficulty in cases of this nature, that being the competing scientific and vernacular definitions of a "mineral."

Here there was evidence to the effect that if calcium could be found in its natural state (good limestone is basically pure calcium carbonate or calcite), it would come within the definition of "mineral" in the geological sense of the word, but in terms of its vernacular meaning, calcium would not be considered to be a mineral. Kennedy J. initially observed that it is what was meant by the term "mines and minerals" at the prevailing time (i.e., between 1890 and 1930) which is relevant and then proceeded to discuss two statutory provisions then in effect. The *Quartz Mining Regulations of 1898* provided that when limestone was mined for building purposes it would not be considered as a "mineral" within the meaning of those regulations. The *Dominion Lands Act*[114] also made clear that the grant of a homestead was for agricultural purposes only, and the lands subject to such grant accordingly did not include minerals having commercial value. Given that Canada Cement was not and had not mined limestone for building purposes, and given further that limestone had known commercial value, Kennedy J. concluded that the

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113. (1990), 65 Man. R. (2d) 28 (Man. Q.B.).

114. R.S.C. 1886, c. 54.

reservations in all of the titles in question effectively reserved to the federal government the ownership of the limestone.

What may be of interest in this case is the Court's use of the statutory definition of a "mineral" in the *Quartz Mining Regulations of 1989* as an interpretive aid. To analogize to the oil and gas industry, we have been advised that the Alberta Land Titles Registrar relies upon the definition of "minerals" contained in the *Mines and Minerals Act*[115], and the interpretation given that definition by the Alberta Department of Energy, in determining questions relating to matters governed by the *Land Titles Act*,[116] which does not contain a definition of "minerals." In the absence of any legislative authority to use such interpretive tools it is arguable that the Court in *Canada Cement* and the Alberta Land Titles Registrar should not be relying on the same. With respect to the Registrar, the point of this argument is that the *Land Titles Act* and the *Mines and Minerals Act* are distinct pieces of legislation, each with their own objectives. As a result, it may be inappropriate for the Registrar to be "transplanting" definitions from the *Mines and Minerals Act* to the *Land Titles Act*. Similarly, the Court in this case may have erred in placing so much reliance upon the definition of "mineral" in the *Quartz Mining Regulations*.

IX. FREEHOLD LEASES

A. *Brick* v. *Enerplus Resources Corp.*[117]

The plaintiff in this action, being the lessor under a freehold petroleum and natural gas lease, had not been paid its lessor's royalties for the months of March, April and May, 1988, and the same were overdue pursuant to the terms of the lease. On July 2, 1988 the lessor sent a notice of default to the lessee with respect to this non-payment. The letter did not specifically claim default for the month of June because, pursuant to the terms of the lease, the lessee was not yet in default with respect to this particular royalty payment.

On August 17, 1988 a single cheque was provided to the lessor representing the royalty payments due for the months of March, April and May, 1988. MacPherson C.J.Q.B. concluded that as the default complained of was remedied by the lessee in the time period specified by the lease for curing such defaults, the lease was not terminated on this basis. The lessor, however, argued that the July 2, 1988 letter also impliedly gave notice to the lessee of default in respect of royalty payments for any subsequent months. MacPherson C.J.Q.B. responded to this argument at page 299:

> I cannot accept this argument. The opening sentence of [the default provision] of the Lease states that: "...the Lessor may give to the Lessee written notice requiring it to remedy *such default*" (emphasis added) and the lessee is then allowed 90 days in which to "remedy *such default*" (emphasis added). In my view, the plain meaning of these words is that the lessee, to maintain the Lease, is required only to remedy the default which has actually occurred and of which notice is given. By delivery to the plaintiff of the

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115. R.S.A. 1980, c. M-15.

116. *Supra*, note 33.

117. (1990), 87 Sask. R. 294 (Sask. Q.B.).

> August 17, 1988 cheque in the amount of $923.26, the defendant did remedy the actual defaults of which notice had been given, and as required by [the default provision]...

As a result, MacPherson C.J.Q.B. held that the lease was not terminated. Of interest is MacPherson C.J.Q.B.'s *obiter* comments with respect to relief from forfeiture, and whether the same would have been granted if he had accepted the lessor's argument. MacPherson C.J.Q.B. remarked at page 301:

> My inclination would have been to refuse relief from forfeiture because of the defendant's negligence and sloppy business practice. . . I do not believe that relief from forfeiture should be granted to a lessee where the forfeiture has occurred due solely to its negligence and faulty business practices.

In any event, and as noted above, the plaintiff's action was dismissed.

X. LEAVE TO APPEAL TO SUPREME COURT OF CANADA

A. *Bank of Nova Scotia* v. *Henuset Resources Ltd.*[118]

Leave to appeal to the Supreme Court of Canada was denied on March 14, 1990.[119]

B. *Friends of the Oldman River Society* v. *Minister of Transport*[120]

This matter was heard by the Supreme Court of Canada on February 19 and 20, 1991, and the Court reserved its decision.[121]

C. *TransAlta Utilities Corp.* v. *MacTaggart*[122]

Leave to appeal to the Supreme Court of Canada was denied on May 17, 1990.[123]

SCHEDULE "A"

Panamericana De Bienes Y Servicios S.A. v. *Northern Badger Oil & Gas Ltd.*
Court of Appeal of Alberta

Four days after this paper was presented, the Alberta Court of Appeal overturned the Alberta Court of Queen's Bench decision in *Panamericana De Bienes Y Servicios S.A.* v. *Northern Badger Oil & Gas Ltd.*[124] In a unanimous decision the Court said that the

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118. (1989), 70 Alta. L.R. (2d) 320 (Alta. C.A.).
119. (1990), 72 Alta. L.R. (2d) L (vi).
120. (1990), 70 Alta. L.R. (2d) 289 (F.C.T.D.).
121. Bulletin of Proceedings of the Supreme Court of Canada, February 22, 1991 at 476.
122. (1990), 71 Alta. L.R. (2d) 251 (Alta. C.A.).
123. (1990), 72 Alta. L.R. (2d) L (vi).
124. (1991), 81 Alta. L.R. (2d) 45, and see also Kuhn, B., Case Comment, (1991), 81 Alta. L. Rev. (2d) 68 [hereinafter *Northern Badger*].

order issued by the Energy Resources Conservation Board (the "Board") must be complied with by the court appointed receiver before any money is distributed to secured creditors.

The Court states that the direct issue in the case is:

> [W]hether the *Bankruptcy Act* requires that the assets in the estate of an insolvent well licensee should be distributed to creditors leaving behind the duties respecting environmental safety, which are liabilities, as a charge to the public.

As in the Court of Queen's Bench, a basic premise of the respondent's position was that the Board had a provable claim in bankruptcy and therefore should simply rank as a creditor. The Court agreed that Northern Badger had a liability for the abandonment of the wells and that this liability was passed on to the receiver. The Court of Appeal disagreed with the Court of Queen's Bench over whether the Board was a creditor of Northern Badger. The duty of proper well abandonment is a duty owed by Northern Badger as a citizen to all other citizens of the community. The Court held that an enforcing authority like the Board was not a creditor when it enforced statutory provisions which are part of the general law of Alberta. Had the Board done the work of abandonment itself it would have become a creditor for the sums expended but this did not occur. Cases where "some actual impost had been levied against the citizen and a sum of money was due and owing to the specific public authority involved" could be distinguished.[125]

The Court ruled against the respondent's contention that the Board order should have been directed to Northern Badger or to the trustee in bankruptcy rather than to the receiver-manager. The receiver-manager had been functioning as a licensee for some time, producing oil and gas from the wells and turning a profit. The receiver-manager could not "pick and choose as to whether an operation is profitable or not in deciding whether to carry it out."[126] The obligations of being a licensee must be accepted as well as the benefits. Interestingly, in this context the Court stated that abandonment expenses were "inherent in the nature of the properties themselves."

The respondents argued that the provisions of provincial statutes are invalid to the extent that they conflict with the federal *Bankruptcy Act*. The Court held that there was no direct conflict in this case. The Alberta legislation is a statute of general application within a valid provincial head of power. Its aim is not to subvert the *Bankruptcy Act* though it may incidentally affect distribution in some cases. Just because two statutes affect the same subject matter does not necessarily mean that one or the other of them is invalid.

The Court states at the end of the judgment that it is not defining the limits of provincial regulatory authority in relation to the federal powers respecting insolvency and bankruptcy. The extent to which a province may incidentally affect distribution on

125. *Ibid.* at 58.
126. *Ibid.* at 65.

bankruptcy will depend on the facts of the particular case because of the myriad of ways the various levels of government regulate business.

The impact of this decision on receivers and trustees in bankruptcy could be considerable but important questions are not yet answered. The Court did not spell out what other "general laws" of the Province would be subject to the reasoning in *Northern Badger*. Environmental legislation is expanding rapidly and the decision could have broad implications regarding debtors subject to environmental concerns.

The order in this case was directed personally against the receiver but the decision is not clear on when this is appropriate. Two factors that are considered are the language of the enabling legislation of the public authority and the degree of control the receiver has over the assets of the debtor. Here the legislation was broadly worded, allowing the Board (with approval of the Lieutenant Governor in Counsel) to make any just and reasonable order to effect the purposes of the legislation. Secondly, control by the receiver was complete. In a case where legislation allowed only orders directed at certain individuals or in cases where the control by the receiver was less complete it is not clear that the same outcome would be reached. Query whether in such cases the receiver would not be personally liable.

Another important question left unanswered by the decision is whether the liability of the receiver is capped at the level of funds available in the estate in a case where the cost of performance of the obligation under the general law of the province exceeds the value of the estate. In *Northern Badger* the question did not arise because the estate contained sufficient funds to properly abandon the wells. The Court did not indicate whether or not the receiver's obligation to comply with the order was limited to the assets of the debtor. Obviously, possible unlimited personal liability is a matter of great concern to receivers when considering whether they will accept an appointment.

It is also unclear what this decision suggests about the nature of abandonment expenses. The reference to such expenses being "inherent in the nature of the properties" raises numerous questions about whether such expenses could be imposed upon prior owners of the property. If this were so, such expenses must be viewed as a reduction in the value of the working interest. On the other hand, the Court placed great emphasis on the degree of control that the receiver exercised over the properties in question. It must be queried whether ownership of the lands is as important as *de facto* exclusive control.

Lenders will want to consider *Northern Badger* when evaluating any security. The value of the security will be lessened by virtue of environmental or safety risks encountered by a borrower. All assets of a debtor may be considered as sources of funds available to satisfy obligations of the sort imposed in *Northern Badger* before realization by the secured party. The effect of the decision on the cost and availability of credit to industries exposed to such rulings remains to be seen.

The lender will also have to consider the implications of the case when deciding whether and how to realize on its security. The lender will have to cautiously determine the potential liability of any receiver and attempt to avoid such liability by being selective

in determining what assets to realize upon and by taking as little control as possible over the debtor's business to effect realization.