Oil & Gas Law

LAW 543

University of Alberta, Faculty of Law

[1. ORIGIN, OCCURRENCE, AND PRODUCTION OF PETROLEUM AND NATURAL GAS]

Definitions/Processes

- **Oil sands:** a mix of naturally occurring bitumen, a thick, sticky oil, and abrasive sand.
  - Each sand grain is coated by a layer of water and a layer of heavy oil
  - Including the oil sands, Alberta has the second largest petroleum reserves in the world, second only to Saudi Arabia.
  - Bitumen content by percent weight varies: deposit containing in excess of 12 per cent bitumen is thought to be rich, while less than 6 per cent is considered less viable.
- **Oilsands mining:** mostly completed by open pit mining
  - The overburden is stripped and stored for future reclamation, scoops of sand are then extracted into trucks, entered into a separation process at the extraction point, upgraded (by splitting or cracking the bitumen), and shipped to refineries, creating a sweet synthetic crude oil, and land reclamation will occur after mining is complete
- **In Situ Development**
  - Bitumen is heated underground before it can be extracted where it is not at the surface
  - Steam-Assisted Gravity Drainage (SAGD) involves horizontal wells–one above the other–that are drilled into an oil sands deposit.
  - Steam is injected into the upper wellbore, heating the deposit and allowing the bitumen to drain into the lower well, where it is then pumped to surface.
- **Shale gas:** refers to natural gas (mainly methane) found in fine-grained, organic-rich rocks (gas shales).
  - Shale describes rocks with more fine-grained particles (smaller than sand) than coarse-grained particles
  - source rocks that are "tight" or "inefficient" at expelling hydrocarbons may be the best prospects for shale gas potential.
  - Drop in pressure is required to get the gas to desorb (detach) from the clays and organic matter
- **Liquid Natural Gas (LNG)**
  - LNG: Is natural gas that is cooled to the point where it condenses into a liquid (-160 c)
  - After cooled to a liquid it takes 1/600th of the space required to store as a gas
  - LNG can be stored and shipped safely because:
    - Colourless, odorless, non-toxic liquid
  - Non-pressurized, non-corrosive
- **Conventional vs unconventional oil and gas:**
  - Conventional oil and gas – has tendency to flow, simpler to extract
    - Flows easily from area of high pressure to low pressure (drilling & striking oil)
  - Unconventional – must be separated (oil sands) or fractured (for gas)
    - Low viscosity, low propensity to flow
    - More expensive to extract, requires more investment of energy

Hydrocarbons

- **Various 'fossil fuel' forms:** Crude Oil, Bitumen, Natural Gas, Coal
- **Standard Metrics:**
  - Oil production: measured in barrels
  - World measurement: price/barrel (159 liters)
  - Canada: price/cubic meter (divide by 6.29 to convert)
  - Gas measurement: mmbtu (1 million British thermal units)
- **Combustion:**
  - Energy is stored in hydro-carbon energy bonds
  - This potential energy is accessed and then put to work (i.e., to heat, to drive, to power) through the process of combustion i.e., $CH4 + O2 + AE \rightarrow CO2 + H20 + E$

Global Market Prices

- **Pricing vocabulary**
  - Brent Crude Oil (UK)—European market that reflects world prices (highest)
    - North Sea Crude: Helps set African/European/Middle East prices
  - West Texas Intermediate (US)—Higher than Alberta, but lower than world prices.
    - They reflect world pricing trends, tend to go up and down in the same pattern, but there is a gap
    - Texas Sweet (low sulfur) Light (low density/wax): North American benchmark for pricing
  - Western Canadian Select
    - Heavy crude (including bitumen) mixed with dilutants
    - Initiated in 2004
    - Priced lower than WTI where traded.

- **A suite of factors affect global oil and gas prices within supply and demand markets, such as:**
    - The strength of key national economies (i.e., China)
    - New unconventional sources coming on line (i.e., American shale oil/gas)
    - OPEC (more specifically, Saudi Arabia) and its production quotas
    - Geopolitical instabilities

Recent Canadian Reorganization and Revenue Decline

- 1. "Bitumen Bubble"?
    - Excess production that cannot find a way to get to market is stockpiled
- 2. USA does not need our natural gas
- 3. USA has considerable oil reserves
    - Natural gas situation is even worse because through horizontal drilling and shale formations there are increased amounts available to the US market from their own land.
    - Within five years, Canada will likely be supplying the US with only 5% instead of an expected 30%.
- 4. USA is not necessarily open to Canadian supply (Keystone?)
- 5. Tide water market expansion is occurring (KM Trans Mountain expansion + Energy East)

5-Phase History of Canadian/Albertan Oil

- **1. 1946-1972: Oil but no market**
    - Situation prior to Canada having even discovered oil would have a huge impact on the discovery of oil in Canada. World was awash in cheap oil.
    - **1946**: oil discovered in Canada (Leduc), however there was no huge rush for it was slightly more expensive
    - AB primary concern was finding markets that would buy it.
    - Canada developed a national energy policy based on the **Ottawa valley rule:**
        - You could only import middle eastern oil as far as the Ottawa Valley border, to encourage use of Canadian oil in the west
        - Enacted under Federal Trade and Commerce power
        - upheld in Caloil v Canada (SCC, 1971)
    - Gas was also being produced at this time, however there was little demand.
    - **1958**: Pipeline debate on a national scale regarding whether the government would build a Transcanada pipeline
- **2. 1873-1981: OPEC crisis**
    - **1973**: price of oil did not change between 1946 - 1972. The mentality was the price would never really change.
    - Then OPEC gained power. Upset with the unfair concession agreements and resentment because of political and economic control by the west, OPEC started to choke off supplies until the price rose. Prices went from $3-$12/barrel
    - Precipitating factors were a few wars including the 6 day war with Israel, backed heavily by Western powers
        - Intense military campaign which crushed the opposition and left them feeling humiliated because Israel was backed by western support who had weapons built from oil revenues obtained from middle eastern countries
    - OPEC's increase of oil prices (and limiting of supply) began to create substantial inflation across the global economy
        - The increase in prices from the Middle East allowed for Alberta oil to be more competitive with the prices being charged
        - Suddenly the value of AB oil was rising, and AB became an energy based economy
        - 1973: AB Leg decided that existing fixed **royalty rate** is abolished, and Lt Governor would periodically set the rate from now on. Went from 12.5% to 50%
            - Aside on Royalties Now – low rate on gross income and higher rate on net income
                - Minimum royalty rate when oil is less than $55/barrel: %1 of gross income and 25% of net income
                - Maximum royalty rate when oil is more than $125/barrel: %9 of gross income and 40% of net income
        - AB started essentially acting like a middle eastern country
        - Rest of Canada was suffering from vast inflation, which started a sense of national resentment towards AB (political time-bomb)
    - **Mid 1970s:** Economic nationalism and anti-corporation was rampant in Canada, especially that the oil profits were going to the US.
        - Fear over foreign ownership
        - Federal government began taking an interest in oil
        - 1975: Petro Canada is established as a national champion.
            - Canada bought a Belgian oil company Petrofina (would not dare attempt to buy Shell (American) or BP)
        - 1977: Concern by Department of Energy that there would be an oil crisis within 10-15 years (although within 10 years oil was back to its pre 1973 prices)
- **3. 1980s: Federal response (NEP/OPEC price collapse)**
    - **Oct 1980: NEP (National Energy Program)**
        - During Boom of 1973-1981 Alberta became wealthy, but the tension it produced led to the creation of NEP

        - Goal was domestic self sufficiency in terms of oil supply, increase fed government revenue from industry and to promote Canadian ownership of a US dominated market
    - Features include:
        - Imposed an excess profit tax on oil companies and secondly when oil companies paid their taxes to the federal government at the excess level they could no longer deduct provincial royalties, it was like a tax on a tax.
            - It was an internal wealth transfer system which said that AB cannot garner all the profit of this price rise
        - Refineries were given subsidies to cover the difference between national and world prices
        - Natural gas: companies would be able to keep the domestic price, however any difference with the world price would be kept by the federal government
        - Every foreign company that held Canadian lands, the rule was that the federal government would take back 25% of its interest without compensation.
        - Brought the industry to a crashing halt as it was no longer worth it to produce, which means the government didn't get the revenues it expected
- **4. 1984 →: Market direction**
    - 1984: Mulroney elected, removed the personnel and philosophy of the NEP (program completely dismantled by 1986)
        - Market should be the driving force behind the price of oil, not the government (equalizes supply and demand).
        - Pre-1986: Export restrictions (greater than 15 year domestic supply required before exports allowed)
            - Resulted in a reduction of exploration
            - Enacted under federal Trade & Commerce power
        - 1986: Export restrictions abolished, Canadian producers allowed to exploit highest domestic or international price of oil
    - 1990's: Alliance pipeline (Alberta to Chicago) transported massive amounts of natural gas
    - 1991/1992: Iraqi invasion of Kuwait (first gulf war), short spike in oil prices
        - Remainder of the 1990's fairly steady decline in the price of oil until 2000 (in 2000 oil prices reached 1986 levels)
        - World suddenly begins to realize they have a large supply of oil so prices continue to drop and people became accustomed to cheap energy
    - 1996: federal/provincial government created an incentive scheme for production of oilsands.
        - Only Suncor/Syncrude existed.
        - Scheme was put in where the gov't agreed to modify its tax/royalty scheme to allow for new oilsands to be made.
- **5. 2000→: New technologies and new consumers**
    - 2000's: Significant increase in consumption (China and India develop as emerging markets)
        - Geopolitical events: 9/11 and invasion of Afghanistan and Iraq, and incredibility hostile regime in Iran. After these, people realized how vulnerable the oil production was
        - Higher oil prices brought about an emergence of technology
            - Directional and Multi-well drilling, as well as hydro-fracking
            - Production of shale gas wells has led to a reduction in both oil and mainly natural gas prices
        - Appears clear that North America is returning again to an abundance of oil and gas
            - Makes it very important for Alberta to develop export opportunities to international markets without depressed oil and natural gas prices

Present Day: Locating Oil and Gas

- **Source beds for different hydrocarbons**
    - Accumulated organic matter decays over time and under pressure
    - Coal: organic material buried in swamps and lagoons
    - Gas and oil: oceanic/deep water
- **Exploration**
    - Surface conditions hint at subsurface features (leaks, ridges, folds, indentations)
    - Seismic 3D imaging will reveal reservoirs, then Exploratory wells are drilled
        - Note: significant sunk costs in finding the resources and drilling before any oil or gas is extracted
- **Oil & Gas Traps**
    - Gas is less dense than oil, so it will always rise to the top of a reserve and create a gas cap
- **(Proven) World Energy Reserves:**
    - Crude Oil: 2011—1476 billion barrels; 2014—1656 billion barrels
    - Natural Gas: 2011—6708 trillion cubic feet; 2014—6973 trillion cubic feet
    - Canadian Oil Reserves: 173 billion barrels (168 billion in the oil sands)

2. OWNERSHIP INTERESTS IN OIL AND GAS SETTLEMENT & TENURE

1. THE DEVELOPMENT OF RESOURCES OWNERSHIP IN WESTERN CANADA

First Order Ownership Questions

- 1. Why do we have the resource ownership ratios that we currently have?
- 2. How do we identify and locate parcels of land (and their subsurface counterparts) within Alberta?
- 3. How to we reconcile development that is occurring on or surrounding First Nations' traditional lands with constitutional protected rights and obligations?

The Importance of Land Tenure

- **Land is needed for exploration & to mine/drill**
  - Boils down to "who owns what?"
- **Presently in Alberta: 81% of mineral rights are held by the Province; only 10% in freehold; the remainder is Federally 'owned' (national parks and reserves)**
  - Vast majority held by province
  - We will focus on the 10% in freehold and the lease instrument
  - Provinces have the benefit of regulations and legislation on the other hand
- ***Land patent*: document ("patent") transfer of land from Sovereign authority**
  - The first document that transfers land from the government to another holder
- ***Land Titles System*: to regularize transactions**
  - Helps keep a record of transaction
  - We have the Torrens Land system in AB
- ***Fee Simple:*** Pretty much full ownership regarding bundle of rights
- ***Freehold:*** fee simple ownership by someone other than the Crown
- ***Freehold lease*:** lease of land held in fee simple by someone other than the Crown

Settlement/Ownership Progression

- To understand the 10% freehold, we have to first go back to the 1670 King Charles II Grant → HBC
  - Favourable transaction to HBC of land
    - Exclusive right to massive area of the world to explore - right to all lands and minerals that drain into the Hudson's Bay
- ***Royal Proclamation, 1763*: Indian/Indian lands (*Calder*, SCC 1973) – p. 20**
  - We get Crown reservation – Under English Law, the Crown owns all lands except that which was granted
  - Prohibited land acquisition by "Indians" at the time
  - No cede and surrender by the FN except to the Crown
  - ***Calder***
    - The Royal Proclamation applies west of the Rock Mountains
- **1867: Confederation (*British North America Act, 1867,* s. 109)**
  - **S. 109.** All Lands, Mines, Minerals, and Royalties belonging to the several Provinces of Canada, Nova Scotia, and New Brunswick at the Union, and all Sums then due or payable for such Lands, Mines, Minerals, or Royalties, shall belong to the several Provinces of Ontario, Quebec, Nova Scotia, and New Brunswick in which the same are situate or arise, subject to any Trusts existing in respect thereof, and to any Interest other than that of the Province in the same.
    - Ownership given to provinces
      - Will become an issue when other provinces join, like AB
- **1869/70: HBC land surrender (money + 1/20th fertile belt) - *Rupert's Land & Northwestern Territory Order, 1870***
  - Ready to sell land back to Canada, in exchange for money and 1/20th of fertile belt – memorialized in the Order
    - Fertile belt = large swatch of land throughout the prairies
  - HBC gets to retain certain sections of land, both the surface and subsurface ownership of these sections
    - They could start selling the title to private people – leads to first kind of way private mineral ownership
- **1871: Canadian Pacific Rail (land grants)**
  - Second major way you see private mineral ownership
  - Canadian government grants to CP ownership both surface and subsurface lands 25 miles around the track

    - CP can now also start selling this land to finance further development
- **Homesteaders (land grants: until approximately 1887-1889, mineral rights included) – p. 22**
    - Grants given by Feds to individuals on the promise that they'd work the land
    - Government got wise to this though, and by 1887 the land grants were **only** for surface title
        - This is why you see **less** ownership from MB **westward** to BC – earlier grants had more surface and subsurface title that was included in the transaction
- **Treaties (i.e., with Plains and Wood Cree, 1876) – p. 22-23**
    - Cede and surrender of lands
- ***Soldier Settlement Acts* (1917 + 1919)**
    - 2 different pieces of legislation from the end of WWI
    - Trying to reward people who served Canada – similar to a pension
    - Gave land to people who came back from the War
    - Sometimes, that came with both surface and subsurface title
        - Could lead to private ownership
- **Manitoba (1870), Saskatchewan (1905), and Alberta (1905) become provinces; resource ownership disparity quickly realized and contested**
    - S. 109 didn't include these new provinces…
- **1930 resource transfer (significantly caveated) to regularize with Canada's original provinces – pp. 24-26**
    - Tried to put new provinces in the same position as the old ones – *An Act Respecting the Transfer of the Natural Resources of Alberta*
- ***Constitution Act, 1867*, ss. 92(a) – p. 27**
    - Tried to solid up provincial ownership of natural resources

6 Exceptions to Provincial Crown M&M Ownership

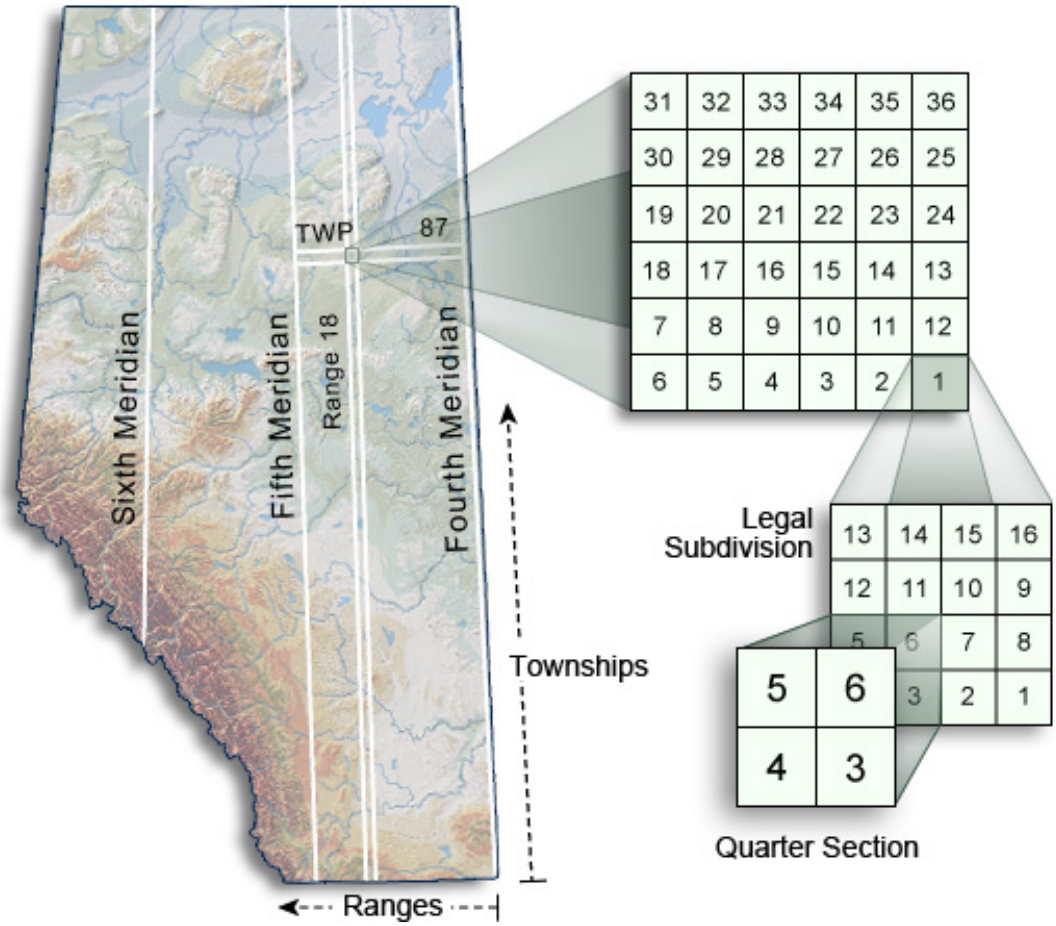
- 1. HBC ownership
- 2. Railway ownership
- 3. Homesteader ownership (pre-1887-89)
- 4. Unique legislation (*Soldier Settlement Act* of 1917 + 1919)
- 5. Federal: Indian Reservation Land / National Park Land
- 6. Lingering claims under *NRTA* (Natural Resource Transfer Agreements)

Federal Government Involvement

- **Interprovincial commerce has kept the Federal government in the energy picture (1956: National Energy Board created; s. 91(2))**
    - We know that interprovincial commerce is federal jurisdiction
    - Note that the NEB has since been replaced by the National Energy Regulator
- **NEB completes environmental assessments and recommends approvals for major infrastructure projects (*CEAA, 2012*)**
- **Federal government is involved re: climate change legislation**
- **Alberta: energy is highly regulated**
    - Alberta Energy Regulator (*Responsible Energy Development Act*)
    - *Oil and Gas Conservation Act*- conserve and prevent waste & for the economic, orderly, and efficient development of the resource in the public interest (etc.)

2. The Influence of Settlement of Land Tenure

Common Land Survey



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  - Meridians = lines of longitude
    - 4th Meridian line
      - Runs along the barrier between AB and SK
    - 5th Meridian line
      - West of Edmonton and transects through Calgary
    - 6th Meridian line
      - Runs through Jasper
  - Lines between meridians = ranges
  - Squares that form between townships and ranges = townships
    - Each township is 6 miles by 6 miles
  - Sinusoidal numbering – numbering within a township
    - Done for ease of creating a pattern
  - A township is 6 miles by 6 miles = 36 square miles
  - Within 1 township there are 36 sections
    - Each section is 1 mile x 1 mile
  - Within 1 section there are 16 legal subdivisions, which are also sinusoidally ordered
  - 16 legal subdivisions can be divided into 4 quarter sections
    - Each quarter-section is a ½ mile x ½ mile

Alberta's Township Survey System

- Applicable to Manitoba, Saskatchewan, Alberta, and Northeast BC ("Peace River Block")
- Situated using longitudinal meridians and latitudinal parallels

- Baseline is the 49th parallel (US-Canada border)
- New East-West baselines set every 24 miles North, with a correction line every 12 miles
    - You're trying to put squares on a globe, so need to account for curvature of Earth
- Range road allowances every 6 miles
    - Allow for different sources of access
- Measured against Meridian lines
- **Range (column of townships)→ Township (6 m^2)→36 Sections (1 m^2)→Legal Subdivision (16 subdivisions; 4 constitute a 1/4 section)**
- Sinusoidal organization of Sections & Subdivisions (SE corner → NE corner)
- *Recall*: HBC in "fertile belt" retained section 8 and ¾ of section 26
    - AKA 3 quarter-sections
- *Recall*: CPR and odd sections within 25 miles of railway, save section 11 and section 29
    - A lot of land, but very narrow belt
- **Numbering: L.S A of B-C-D-WE**
    - A = Legal subdivision #
    - B = Section #
    - C = Township #
    - D = Range #
    - E = Meridian # (4/5/6)

Example Question of Calculating Distance Between Parcels

- Locate
    - **Parcel 1: L.S. 16 of 33-37-24-W4 – Locate it!**
        - Legal subdivision → Section → Township → Range → Meridian
        - Legal subdivision 16 of Section 33, Township 37, Range 24, W of the 4th Meridian
    - **Parcel 2: L.S. 3 of 16-29-22 W4 – Locate it!**
    - **Parcel 3: L.S. 8 of 11-110-11 W5 (28 ranges between 4th and 5th meridians) – Locate it!**
- **What is the relative distance between Parcels 1 and 2?**
    - Parcel 1
        - 36 completed townships before x 6 = 216 + 5.75 additional = 221.75
            - The bottom edge is 221.75 miles north of the 49th parallel
        - 23 completed ranges before x 6 = 138 + 3 = 141 (west of the 4th meridian)
            - Edge is 141 miles west of the 4th meridian
        - Should be able to draw this out too
    - Parcel 2
        - 28 townships x 6 = 168 + 2 = 170 miles north of 49th parallel
        - 21 ranges x 6 = 126 + 3.5 = 129.5 miles west of the 4th meridian
    - Distance between the 2 (vertical and horizontal distances)
        - Townships
            - 221.75 – 170 = 51.75 miles
        - Ranges
            - 141 – 129.5 = 11.5 miles

3. Duty to Consult and Accommodate

Introduction

Treaty Lands

-
    - We're talking about Treaties 6, 7, and 8

Aboriginal Rights

- **Common Law (pre-1982) → Constitutional (post-1982)**
- *Recognition of existing aboriginal and treaty rights*
- **Section 35**
    - (1) The existing aboriginal and treaty rights of the aboriginal peoples of Canada are hereby recognized and affirmed.
    - (2) – Definition of "aboriginal peoples of Canada"
        - In this Act, "aboriginal peoples of Canada" includes the Indian, Inuit and Métis peoples of Canada.
- Section 35 gives recognition to existing aboriginal and treaty rights
- Pre-1982, it was easier to extinguish rights
- Aboriginal law vs Indigenous law
    - Aboriginal law – colonial law imposed on Aboriginal peoples
    - Indigenous law – looks at legal traditions of Aboriginal peoples

Common Law Progression

Calder v BC (1973 SCC) – Title Exists but Not in This Case; Title Predates Royal Proclamation; Royal Proclamation Applies West of the Rockies

- **Facts**
    - Appellants, suing on their own behalf and on behalf of all other members of the Nisga'a Tribal Council and four Indian bands, brought an action against the Attorney-General of British Columbia for a declaration "that the aboriginal title, otherwise known as the Indian title, of the Plaintiffs to their ancient tribal territory… has never been lawfully extinguished".
        - Nisga'a title claim to 2,600 square kilometers in northwestern British Columbia.
        - The action was dismissed at trial and the Court of Appeal rejected the appeal.
- **Holding**
    - Aboriginal title exists, but it was extinguished in this case
    - Appeal dismissed
- **Ratio**

- Aboriginal title exists as a legal right derived from historic occupation and possession of tribal lands and predates the Royal Proclamation
    - Confirmation that the *Royal Proclamation* applies west of the Rocky Mountains
    - Propagated future title claims and drove land claim agreements
- **Notes**
    - **Nisga'a title claim to 2,600 square kilometers**
        - This title claim was **not** successful
        - Note that Aboriginal title is a **form of an Aboriginal right**
            - How does it differ then?
                - Traditional rights (right to hunt, gather) are collectively held, but **individually** exercised
                - Aboriginal title is different: it's a collective right that implies **collective action**/collective governance decision-making
            - It is a sui generis right
        - Started a movement towards claims
    - **Confirmation that the *Royal Proclamation* applies west of the Rocky Mountains**
        - Royal Proclamation: Land for FN could not be ceded except to the Crown
    - **Propagated future title claims and drove land claim agreements in B.C.**

R v Sparrow **(1990) – Justified Infringements of Aboriginal Rights**

- **Facts**
    - Musqueam food fishing licence dictated by Fisheries Act. Band member charged with offence of fishing with net longer than permitted by food fishing licence.
        - Defence: exercising existing aboriginal right to fish and net length restriction is inconsistent with s 35 of Constitution Act and is therefore invalid
        - Case where there is a contest between environmental law and regulation and on the other hand, an Aboriginal right to carry out an activity
- **Issue**
    - Whether parliament's power to regulate fishing is now limited by s 35(1) of the Constitution and whether the net length restriction in the licence is inconsistent with that provision?
- **Holding**
    - New trial, Band needs to show that shorter fishing nets infringe collective aboriginal right to fish for food, and if that is found, then crown must demonstrate that regulation is justifiable.
    - **"Sparrow Test" for rights infringement:**
        - 1. Existing Aboriginal Right?
            - Specific nature of the right defined
            - Right is integral to the distinctive culture prior to contact
            - Was the right extinguished? – with clear and plain intent
        - 2. Prima Facie Interference
            - Proposed regulatory action an interference with the right because it is:
                - Unreasonable?
                - Imposes undue hardship?
                - Denies the right holder the preferred means of exercising the right?
        - 3. If the right exists and is infringed, can the infringement be justified because of: a valid legislative objective; and with the honour of the Crown being upheld (consistent with fiduciary relationship)?
            - Legislative objective – substantial and compelling – e.g. public safety, conservation
        - Honour of the Crown – meaning that the action must be aligned with the fiduciary relationship between the Crown and Aboriginal peoples
- **Ratio**
    - Test for interference with an existing aboriginal right and for the justification of interference
    - Recognition that existing rights that receive constitutional protection are those that were not extinguished prior to 1982
- **Notes**
    - **Musqueam FN charged with violating the *Fisheries Act* by using an improper net (i.e., not permitted under the regulations)**
        - Challenge made as to whether it was a valid infringement
    - **Recognition that the rights that received constitutional protection were those that were not extinguished prior to 1982**
    - **Various ways that rights could be extinguished; however, infringement must be justified**
    - **"Sparrow Test" for rights infringement**
        - 1. Existing Aboriginal Right?

- 2. Proposed regulatory action an interference with the right because it is: Unreasonable? Imposes undue hardship? Denies the right holder the preferred means of exercising the right?
- 3. If the right exists and is infringed, can the infringement be justified because of: a valid legislative objective; and with the honour of the Crown being upheld?

R v Badger **(1996 SCC) – Right to Hunt on Privately Owned Land Permitted If Unoccupied and Not Put to Visible Use**

- **Historical Background**
  - Treaty 8 right to hunt guaranteed, subject to government taking up for valid objectives and regulatory actions
    - Limited geographically and by government regulation (safety or conservation)
  - **1899**: Treaty 8 was signed, surrendering portions of northern BC, Alberta, Saskatchewan and the Northwest Territories. Part of the agreement included a guarantee of the right for Indians to continue hunt, fish and trap on the surrendered land.
    - The right applied to all Treaty 8 territory, with the exception of land **"required or taken up**" for settlement or commercial resource extraction. The right was also subject to regulation for conservation purposes.
  - **1930**: Paragraph 12 of the *NRTA* addressed the rights of Indians to hunt:
    - 12. In order to secure to the Indians of the Province the continuance of the supply of game and fish for their support and subsistence, Canada agrees that the laws respecting game in force in the Province from time to time shall apply to the Indians within the boundaries thereof, **provided however, that the said Indians shall have the right, which the Province hereby assures to them, of hunting, trapping and fishing game and fish for food at all seasons of the year on all unoccupied Crown lands and on any other lands to which the said Indians have right of access.**
- **Facts**
  - Mr. Badger, Mr. Kiyawasew and Mr. Ominayak all had status as Cree Indians under Treaty 8. All three admitted to shooting moose on privately owned lands within Treaty 8 territory.
  - Mr. Badger was charged under the *Wildlife Act*, for hunting out of season, while Mr. Ominayak and Mr. Kiyawasew were both charged for hunting without a licence.
  - All three challenged the constitutionality of the *Wildlife Act* provisions, for infringement of their s. 35-protected Treaty 8 rights.
  - The cases were heard together, lost at Provincial Court, appealed to the ABQB (dismissed), appealed to the ABCA, dismissed on grounds that the *NRTA* had extinguished Treaty 8 rights, and regardless, those rights did not apply on private land.
- **Issue**
  - Whether or not Treaty 8 right to hunt still existed, or had it been extinguished or replaced by the *NRTA*? If it did still exist, could it be exercised on private land?
- **Holding**
  - Mr. Badger's and Mr. Kiyawasew's appeals dismissed; Mr. Ominayak's appeal allowed
  - **The NRTA does NOT extinguish the Treaty 8 right to hunt for food**
    - The *NRTA*, while both limiting and expanding hunting rights under Treaty 8, does not extinguish that right; to do so would require clear and plain intent.
  - **The right to hunt extends to "unoccupied" private land**
    - Right of access under the *NRTA* is limited to access **for the purposes of hunting**.
    - Historical evidence, which should be taken into account when interpreting treaties, suggests that Treaty 8 Indians would have understood **"required or taken up,"** to mean ***put to a use that was not compatible with the exercise of the right to hunt.***
    - For Treaty 8, that is, where there were fences, buildings, crop fields or domestic animals present.
    - **Where land is occupied, as indicated by visible, incompatible use, there is no right of access to hunt.**
    - Mr. Badger & Mr. Kiyawasew were hunting on occupied land; Mr. Ominayak was not.
  - **Licensing requirements of the *Wildlife Act* infringe unjustifiably on Treaty 8 right**
    - The provisions *prima facie* infringe Mr. Ominayak's Treaty 8 rights, and have not bene justified
    - A new trial is ordered to consider the issue of justification
- **Ratio**
  - Treaty 8 First Nation members have the right to hunt on private land if land is unoccupied and not put to visible use
- **Notes**
  - **Treaty 8 right to hunt guarantee – page 29**
  - **Limited geographically and by government regulation (safety or conservation) – page 30**
  - **Here, hunting on private lands. May or may not have a "right of access" – without the right of access, *Wildlife Act* prohibitions apply**
  - **Test: *unoccupied + not put to visible use***
  - 3 different parcels of land
    - One that was pretty developed farmland

        - Court: Evidence of occupation that excluded this land from being accessible to FN
    - Second one was also farm area with less signage; were hunting on a field recently tilled
        - Court: This is enough to satisfy occupation
    - Third one was hunting in an area of muskeg
        - Court: This kind of land didn't meet the indicia of being occupied → have the right to hunt here

Delgamuukw v BC **(1997) – Test for Aboriginal Title; Consultation Required to Justify Interference with Aboriginal Rights**

- **Facts**
    - Gitxsan or Wet'suwet'en chiefs claimed 58,000 km of BC under aboriginal title; BC counterclaimed that the appellants had no right or interest in the territory, or that the cause of action ought to be for compensation from Government of Canada.
- **Issue**
    - Nature and scope of constitutional protection afforded by s. 35(1) to common law aboriginal title
- **Holding**
    - Appeal allowed in part; new trial ordered, but suggests negotiation as better method of resolution
    - **What is the Content of Aboriginal title?**
        - Aboriginal title encompasses right to exclusive use and occupation of the land held pursuant to that title for a variety of purposes, which need not be aspects of Aboriginal Practices integral to distinctive Aboriginal Cultures
        - Right to choose the uses of the land, within the inherent limit
    - **General Features of Aboriginal Title:**
        - **Sui generis**: must be understood through common law and aboriginal perspectives, no freedom of transfer, derived from pre-contact occupancy
        - **Inalienability**: Cannot be transferred, sold or surrendered to anyone but crown
        - **Source**: Aboriginal title was recognized by the Royal Proclamation of 1763, but arises from prior occupation of Canada by Aboriginal peoples.
            - Relevant by physical fact of occupation
            - Arises from possession before assertion of British sovereignty vs. normal estates like fee simple, which arise afterward
        - **Communally held** = collective right to land held by all members of ab. Nation. Decisions made communally
        - **Inherent Limitation:** Range of uses is subject to limitation that they must not be irreconcilable with nature of the aboriginal attachment to the land
        - Compensation payable if Title is infringed; which it can be, based on the ***Sparrow*** test
        - Where it exists (or may exist), duty of consultation is engaged prior to action/decisions taking place
    - **Test for Title**
        - 1) Occupied prior to the assertion of Crown sovereignty
        - 2) Exclusive occupation
        - 3) Continuous occupation (oral history with equal evidentiary value)
    - **Difficult test to meet**
        - Can title claims be made in Alberta? – possibly, but only by First Nations that did not sign treaties
- **Ratio**
    - Test for Aboriginal title based on occupation prior to British sovereignty, continuity of occupation, and exclusive occupation
    - There is a duty of consultation that must be satisfied prior to infringing Aboriginal title or an Aboriginal right
- **Notes**
    - **Aboriginal title as a *sui generis* interest in land**
    - **Affords right to exclusive use & occupation & right to choose the use that land is put to. Inalienable, except to the Crown**
    - **Compensation payable if Title is infringed; which it can be based on the Sparrow Test**
    - **Where it exists (or may exist), duty of consultation is engaged prior to action/decisions taking place that affect it**
    - **Elucidates a test for title; difficult to meet**
        - Had to prove exclusive occupation since the declaration of sovereignty – long time
        - Since a lot of tradition was passed down orally, oral evidence was allowable

Haida Nation v BC **(2004) – DTC When Crown has Real or Constructive Knowledge of Potential Aboriginal Right Claim (Or Title Claim) and Action Contemplated that Will have Adverse Effects**

- **Facts**

- Province unilaterally decided to change and redistribute tree farming licences (TFL) over land where the Haida Nation claims title

- **Analysis**
  - **Duty to Consult**
    - The duty to consult is grounded in the principle of "Honour of the Crown" (fiduciary relationship)
    - Honour of the Crown requires that s 35 rights be determined, recognized and respected.
  - Good faith:
    - Agreement not necessary but commitment to a meaningful process undertaken in good faith is required
    - Good faith obligation is reciprocal
  - **Scope and nature of duty:**
    - Consultation and resulting accommodation exists along a spectrum
      - The more critical the right, the stronger the claim, and the greater the potential adverse impact, then the greater the degree of consultation expected
- **Holding**
  - Government had duty to consult with and accommodate Haida with respect to harvesting red cedar timber on lands where Haida had claimed aboriginal title.
- **Ratio**
  - There is a Constitutional duty to consult arises when the Crown has knowledge, real or constructive, of the potential existence of an Aboriginal right or title claim and the Crown contemplates conduct that might adversely affect it; that duty extends to rights and titles that have been asserted but not fully litigated
  - Process of consultation may lead to the duty to accommodate by adapting decisions/policies
- **Notes**
  - **Sets down what is required to uphold the honour of the Crown, which is engaged by s. 35 and the Crown's fiduciary obligations**
  - **Constitutional DTC and accommodate even before rights are proven; triggered with real or constructive knowledge of potential right; agreement not necessary but commitment to a meaningful process undertaken in good faith is required**
  - **Result of consultation dictates necessary accommodation**
  - **Consultation and resulting accommodation exists along a spectrum**
    - If a very significant right that is going to be impacted beyond minimally, there's going to be added responsibilities; compared to a right that's not essential to the FN

Mikisew Cree First Nation v Canada (Minister of Heritage) **(2005 SCC) – DTC Also Applies to Infringements of Treaty Rights, and Exists on a Spectrum; Low Infringement Requires Lower Level of Consultation**

- **Facts**
  - The Mikisew Cree were among the First Nations who lived in the areas surrendered under Treaty 8.
  - In exchange for the surrendered land, the Mikisew Cree received, amongst other things, the rights to hunt, trap and fish throughout the surrendered land **except "such tracts as may be required or taken up from time to time for settlement, mining, lumbering, trading or other purposes".**
  - In 2000, the federal government approved a winter road, which was to run through the Mikisew reserve
  - Mikisew were not consulted on the proposed road despite their protestations and potential impact on guaranteed treaty rights
  - Federal Court of Appeal
    - Found that the building of a winter road was properly seen as a "taking up" of surrendered land in accordance with Treaty 8 and therefore not an infringement of the treaty
- **Analysis**
  - Is the Duty to Consult Triggered?
    - Here, the impacts of the proposed road were clear, established, and adverse to the continued exercise of the Mikisew Treaty 8 rights; Therefore, the duty to consult is triggered.
  - **What is the extent of this duty to consult?**
    - The duty to consult exists on a spectrum and all relevant factors should be considered when determining the extent of consultation required to fulfill this duty.
    - Considering that the proposed winter road is considered minor (23 square kilometres) and will be built on surrendered lands where the Mikisew treaty rights were **expressly** subject to a taking up provision, the necessary consultation to fulfill the duty would be found at the lower end of the spectrum:
      - provide notice to the Mikisew and to engage directly with them.
    - Crown must demonstrate an "'intention of substantially addressing [Aboriginal] concerns' . . . through a meaningful process of consultation" (Haida Nation)
  - Did the Crown fulfill this duty to consult?

        - No! They failed to discharge their obligations.
        - The Crown unilaterally declared the road re-alignment and never engaged in any sort of dialogue with the Mikisew that would demonstrate a good faith interest in addressing their concerns.
- **Holding**
    - Minister's approval of the winter road project quashed; the Crown must consider the impact that "taking up" would have on the Mikisew treaty rights to hunt, fish, and trap and address these issues by consulting in good faith.
    - Appeal allowed
- **Ratio**
    - Duty to consult applies to treaty rights, not just Aboriginal rights and title
    - Also: there must be causation between the proposed government decision/activity and impact on the Aboriginal rights
- **Notes**
    - **Details Treaty 8 – p. 30**
    - **Concerns: construction of a winter road that was first proposed to be developed through reserve land and then moved to the edge of the reserve**
    - **Mikisew were not consulted on the proposed road despite their protestations and potential impact on guaranteed treaty rights**
    - **Yes, Treaty 8 allows for the "taking up" of land; however, the process of "taking up" requires consultation**
    - **Minister's approval of the winter road project quashed**
    - ***Grassy Narrows First Nation v Ontario (Natural Resources*) (2014)**

Gitxaala Nation v Canada **(2016 FCA) – Environmental Impact Assessments Can Be Used to Discharge DTC; Aboriginal Group Must Be Reasonably Satisfied, No Perfect Satisfaction Required; Northern Gateway Project**

- **Background**
    - In 2005, Enbridge Inc. formally approached the National Energy Board (NEB) and the Canadian Environmental Assessment Agency (CEAA) to seek approval for the Northern Gateway Project, a proposed pipeline project that would transport oil from Alberta to Kitimat on the BC coast.
    - In order to review Enbridge's application for the project, Canada created the Joint Review Panel (JRP).
    - CEAA outlined a five-phase consultation plan in order to discharge the Crown's duty to consult and accommodate Aboriginal interests:
        - 1. *Preliminary Phase:* Consultation on draft Joint Review Panel agreement.
        - 2. Pre-hearing Phase: Information would be supplied to Aboriginal groups, who would be encouraged to participate in the review process.
        - 3. *Hearing Phase:* The JRP would hold public hearings, where Aboriginal groups would participate in deliberations, dialogue, and exchange information with the Panel.
        - 4. *Post-Report Phase:* After the JRP releases its report, the Crown would consult Aboriginal groups before the Governor in Council made its decision.
        - 5. *Regulatory/Permitting Phase:* Post-decision consulting on secondary issues.
    - Although the CEAA and the NEB ran the process, all decisions concerning the application, sections 52 and 54 of *the National Energy Board Act* and section 31 of the *Canadian Environmental Assessment Act* empower the Governor in Council to make all final decisions
- **Facts**
    - The Crown parties engaged in consultation with potentially affected Aboriginal groups as per the plan; while the first three consultation phases were extensive, the post-report phase was completed quickly with minimal consultation.
    - The Governor in Council approved the project, and some of the Aboriginal groups disputed the decision in the Federal Court of Appeal.
    - These groups sought to have the Order in Council approving the project quashed; they argued that the project was prejudged, that the consultation process was unilaterally imposed, over-delegated, inadequately funded, ignored some issues, and was too generic, that Canada failed to share its legal assessment of the strength of affected Aboriginal rights or title claims
- **Analysis**
    - **Duty to consult**
        - The duty to consult is grounded in the honour of the Crown and guided by the process of reconciliation and need for fair dealing (para 171).
            - The duty arises when the Crown is aware of the *potential* existence of an Aboriginal right or claim to title, and the level of consultation required varies with the strength of that claim (para 172-174).
        - Continuing duty: expected that throughout the permitting, approval and licensing process, as well as in the development of a land use strategy, the Crown would continue to fulfil its duty to consult, and if required, accommodate.
        - Good faith consultation may reveal a duty to accommodate.

    - **The Crown failed to communicate its view of the strength of the Aboriginal claims**
        - In the later consultation phases, the Crown categorically refused to provide Aboriginal groups with any official statements or information concerning its view of how strong it thought their affected rights and title claims were.
        - Information concerning claim strength that the Crown gains when researching the project should be shared with affected Aboriginal groups in good faith.
    - **The Crown failed to engage in a reasonable level of post-report consultation**
        - Although the consultation process was well organized and mostly well executed, Phase IV of the consultation process was inadequate:
            - Deadlines on consultation cannot be arbitrary and unjustified, which was the case with phase IV (para 284).
            - Aboriginal concerns must be directly addressed and substantively responded to (even if ultimately dismissed) (para 255).
- **Holding**
    - Quashed the Order in Council directing the NEB to order the necessary Certificates to begin construction
    - NEB had taken issue with what the government had done in phase 4: efforts fell short
        - Information and concerns came to light but the government did not respond
- **Notes**
    - **Re-states existing jurisprudence on consultation**
    - **Recognizes that Environmental Impact Assessments can be utilized to discharge the duty *(Taku River)***
    - **Articulates the standard (reasonable satisfaction and NOT perfection)**
        - Government just needs to have acted reasonable
    - **Took a detailed look at the consultation process leading to the Governor in Council's approval of the Northern Gateway Pipeline**
    - **Quashed the Order in Council directing the NEB to order the necessary Certificates to begin construction**
    - What would the government do to make this work?
        - Redo consultations in a way that meets the issues identified

2017 SCC Companion Cases

- ***Clyde River (Hamlet) v Petroleum Geo-Services Inc* (2017 SCC)**
    - NEB is the final decision maker for authorizations to explore and/or drill for gas in designated offshore areas
        - NEB = National Energy Board; federal level body
        - Has since been replaced with the Canadian Energy Regulator
        - Note that the ERCB is a predecessor to the Alberta Energy Regulator (AER)
    - Application for offshore seismic testing; granted by NEB
    - NEB concluded that the proponent had conducted adequate consultations with the affected First Nations and given them adequate opportunity to participate
- ***Chippewas of the Thames First Nation v Enbridge Pipelines Inc* (2017 SCC)**
    - NEB as final decision maker for application to reverse the flow of a pipeline, increase its capacity, and modify it to carry heavy crude
    - NEB approved the project and concluded that the First Nations had been adequately consulted
- General notes
    - **The constitutional duty is owed by "the Crown"**
    - **The Crown is, in one sense, the personification of the Monarch. In another sense it captures the executive's formal legislative role (i.e., assenting to bills)**
    - **While the Crown may rely on a regulatory process to discharge its consultation obligations (either wholly or in part), the Crown bears ultimate responsibility and must fill any gaps and/or improve the consultation process as required**

Tsleil-Waututh Nation v Canada (AG) (2018 FCA) – Consultation Process Must Be a Two-Way Dialogue in Good Faith with Potential for Meaningful Outcomes

- **Facts**
    - Similar phase-wise process to Northern Gateway (***Gitxaala***)
- **Analysis**
    - Court recognizes that the government made improvements compared to the Northern Gateway process
    - Ultimately failed because in a phase similar to Phase IV in ***Gitxaala***, the government sent government officials back out before the Governor in Council made a final decision (Phase 3 in this case).
        - The court reviewed the consultations and determined that they still fell short of the mark
        - It must be a dialogue in good faith with the potential for meaningful outcomes.
        - In this phase, what resulted was **not a dialogue – the process was reduced to mere note taking**

        - The officials did not respond nor did they move the concerns forward in a way that would satisfactorily be address by the Governor in Council
    - While not in bad faith, the consultation still failed to live up to the satisfaction of the jurisprudence up to that point
- **Ratio**
    - The consultation process must be a dialogue (two-way) in good faith with potential for meaningful outcomes.
- **Notes**
    - Phase-wise consultation
    - Why did it fail?
        - Found an improved overall consultation process, but they failed to live up to the standards
        - Like ***Gitxaala***, it failed on the phase after the environmental assessment
        - There were lingering concerns that weren't addressed
    - On Phase III
        - **To summarize my reasons for this conclusion, Canada was required to do more than receive and understand the concerns of the Indigenous applicants. Canada was required to engage in a considered, meaningful two-way dialogue. Canada's ability to do so was constrained by the manner in which its representatives on the Crown consultation team implemented their mandate. For the most part, Canada's representatives limited their mandate to listening to and recording the concerns of the Indigenous applicants and then transmitting those concerns to the decision-makers.**
            - Heard the concerns and passed them along, but there was no two-way discussion or attempt to reach some kind of compromised position
            - After all this the government decided to re-do Phase III

Consultation Questions

Consultation or Consent?

- **Canada: Right of Consultation, consent required only if a project affects land subject to aboriginal title (as affirmed in *Tsilhqot'in Nation v. British Columbia*, 2014)**
- **Also, consultation duty does not extend to the legislative process (*Courtoreille v. Canada,* 2017)**
    - When the legislative body is doing its process of making laws in the HOC, this doesn't require consultation

Consultation Requirements

- **Depth of Consultation differs according to strength and nature of Aboriginal claim**
    - Recall it exists on a spectrum
- **Extent of consultation can vary from mere notice of proposal to long term, in-depth consultation**
- **Consent is *not* required, with almost certain exception of infringements of Aboriginal Title**
- **Good faith is required on both sides**
- **Resulting accommodation is dictated by the outcome of the consultation**

When is the Duty Triggered?

- Where government decision/action has a potential adverse impact on:
    - **Aboriginal title to land**
    - **Aboriginal rights or interests in land, short of ownership**
    - **Rights established by treaty, including: land-based rights to hunt, fish, trap, and gather/harvest**

Who Must Be Consulted?

- **Duty to Consult is restricted to Aboriginal People**
- **Which Aboriginal People? Those who can make a strong prima facie case that they hold rights in the affected area**
    - These don't have to be proven rights, just asserted rights
- **There is a need to show a nexus between the proposed activity and the affected right**
    - Needs to be a connection

What is Proper Consultation?

- **No unreasonable timelines imposed**
- **Government positions and decisions properly explained**
- **Aboriginal concerns considered and addressed**
- **Crown deals reasonably & takes Aboriginal Rights seriously**
- **No "sharp dealing"**
    - Goes with the idea of good faith
- **Can take place as part of the Environmental Assessment process *(Taku River First Nation v British Columbia,* 2004*)***

Creating Strong Relationships

- **Careful attention to Provincial Consultation Policies**
- **Retain a meticulous record of all consultations**
- **Show a record of each identified Aboriginal concern**
- **Show a response to each concern**
- **Consider local assistance at inception of project: e.g. Provision of Baseline Data (including traditional knowledge)**
- **Consider financial assistance to allow effective consultation**
    - There's a difference between communities in Edmonton vs those that are far north
- **Evidence of a genuine willingness to modify project in light of concerns**
- **Accommodate First Nations' interests where possible**

Impact Benefit Agreements

- **Secure the support (or non-objection) of First Nations**
- **Provide continuing consultation during construction and operation of project in interests of long term harmony**
- **Avoid mere payment of a Cash Bonus and focus rather on creating Lasting Community Benefits**
- **Ensure that the project provides long term benefits**
    - E.g. improved access, water

Promising Models

- **Cameco Uranium Project in Western Australia (22 Aboriginal employees in initial workforce)**
    - Workforce participation
- **Syncrude Canada (approx. 500 First Nations employees, $1.2 billion spent with First Nations businesses)**
- **Mackenzie Valley Pipeline (Aboriginal Pipeline Group has right to purchase 33% interest)**

4. BASIC OWNERSHIP THEORY

Ownership Questions

- **Who owns oil and gas before it is produced?**
- **Why is ownership in coal different than oil/gas?**
    - One's a solid and one's a fluid
- **What is required to perfect ownership?**
    - Nothing according to Texas model, versus capturing in like in the Oklahoma model
    - Pennsylvania model seems to be the one followed though (somewhere in the middle)
- **Can you transfer/register your interest in oil and gas as an interest in land?**
    - Yes, according to ***Landowners Mutual***
- **Can your interest in oil and gas be defeated by your neighbour?**
    - Yes, this is possible

Minerals and Mines

- **Common law definition of a mineral**
  - ***Mineral***: anything that can be obtained sub-surface, for profit, from a mine
  - ***Mine***: the space that encloses/envelopes the mineral
  - Oil and gas seem to fit this logically
    - It is contained within a perforated rock
  - *Cuius est solum, eius est usque ad coelum et ad inferos*
    - Note traditional property ownership (to the heavens and hell below)
- **Common law alteration by statute *(Mines and Minerals Act)***
- **Gold and silver *always* vest in the Crown**

Oil/Gas vs Other Minerals and Questions that Arise

- **Migratory substances in an underground reservoir**
  - Coal looks like a traditional mineral
  - Oil/gas exists in a reservoir; once it's punctured
- **Once a reservoir is pierced and production commences, oil (or gas) percolates through permeable rock and moves from areas of high pressure towards the lower pressure producing area to equalize pressure**
  - If conventional, it'll move from high to low P
- **Thus, an oil well at one end of a reservoir will end up draining substance that was originally on the reservoir's other end**
  - By implication, this movement to equalize pressure will drain a reservoir from all areas of containment
- **How can you convey an interest (i.e., a landowner granting an oil company the right to produce oil) when the subject of the interest may not be 'owned' until it is reduced to possession?**

Possible Theories?

- **Fugacious (*def*: fleeting; with a tendency to disappear) substances challenge property laws**
  - Courts have traditionally said that o/g poses issues with laws since it's fleeting, and not moving analogous to other things
- There are some different theories on this from the USA
  - They did not come to a common understanding
- **American Approaches to the Petroleum Lease:**
  - ***Texas*** – Absolute ownership; separate fee simple created by an oil and gas lease. Caveat: the fee is "defeasible" (p. 39)
    - Owner of a parcel of land owns the o/g under their property lines absolutely in fee simple
    - What they would be transferring to someone who wanted to work their land is fee simple
    - It is **defeasible though**: If the owner loses some of the o/g that is under their property by virtue of adjacent development, they have **lost** ownership – it can be defeated by your neighbor's activity
  - ***Pennsylvania*** – Ownership is something less than fee simple; not perfected until brought to the surface and possessed. Lease grants an incorporeal right to explore; title perfected upon possession (p. 40)
    - You don't have true ownership of subsurface substances until they're brought to the surface and stored
    - An o/g lease here creates an incorporeal right = right to carry out something with exclusivity
      - A corporeal right would be absolute ownership
  - ***Oklahoma*** – Exclusive explorative interest is all that can be granted & it is separate from any interest in land. Thus, analogous to *ferae naturae* (p. 40)
    - Actual comparable for o/g is wild animals – no one owes anything until you capture it
    - All you can have is an exclusive exploratory interest; separate and distinct from any other interest in land since this is a unique substance
  - The theory that gains prominence – Pennsylvania theory
  - Alberta is also closer to the Pennsylvania theory

English Decisions

- ***Borough of Bradford v Pickles* (1895)**
  - Pickles drilled intersecting wells to stop flow of water to Bradford
  - Could Bradford sue Pickles for taking their water?
  - Court
    - No, Pickles wins
    - This likely means that the city paid Pickles to stop him

    - Is this what we want in the context of o/g?
        - Maybe/maybe not
- ***Trinidad Asphalt Co.*** **(1899)**
    - Asphalt pit is like a tar pit
    - This tar pit ran through 2 properties
    - Property #2 got creative – started digging near property line so slowly asphalt would slowly come onto their property
    - How do you stop this/ stealing neighbor's asphalt: Right of support
        - Can't undermine the stability of your own property
        - Company was held accountable on this basis
- ***Burma Oil Company Ltd.*** **(1929)**
    - Situation of flowing gas
    - Court said theory analogous to Oklahoma theory – need possession before you have any significant interest
- Canada didn't like any of these

Early Canadian Decisions (*Borys*)

- **Profit a prendre**: An incorporeal (intangible) right to take from another person's land something that is part of the soil or is on the soil and is the property of the landowner.
    - Right to take something from the owner's land that is otherwise the owner's
    - Exclusive right for a company to come on the land, work the land, and win the substance
    - From that substance, you have to create a way to get paid
- ***Borys v. CPR & Imperial Oil Ltd*** **(1952 UKHL) (p. 41)**
    - Plaintiff, who had title to all minerals except coal and petroleum, claimed an injunction against the production of gas by the defendants who had title to "all petroleum".
    - The defendants argued that the term "petroleum" includes "natural gas" but, failing in this argument, claimed to be entitled to use such gas as was necessary to produce the oil.
    - Lord Porter - if any oil or gas situated in a landowner's property filters from it to the surrounding lands, then the former owner has no remedy.
        - Must mean that the landowner has no ownership of the oil and gas in place.
    - Lord Porter added, however, that for the purpose of its decision the board was "prepared to assume that the gas whilst in situ is the property of the Appellant even though it has not been reduced into possession"

Landowners Mutual Minerals Ltd v Registrar (1952 SKCA) – Petroleum and Natural Gas Are Minerals; Therefore, Can Be Transferred

- **Facts**
    - Saskatchewan farmers owned M&M
    - They pooled their rights and tried to transfer to Keystone an undivided ¼ interest in all petroleum, NG and all related hydrocarbons except coal and valuable stone
    - When they tried to register the interest in land the registrar refused to execute the conveyance
    - The registrar said that they cannot convey oil and gas, as they are trying to transfer an interest in a fugacious (unfixed) substance, rather than an interest in land.
- **Issue**
    - Whether interests in petroleum and natural gas are an interest in land and can be transferred and registered under the *Land Titles Act?*
- **Analysis**
    - Reason advanced for holding that oil and natural gas are not minerals and not a part of land capable of being transferred:
        - That they are "fugitive and vagrant in their habits", and the surface owner cannot be said to have absolute property in them until he has mined them and reduced them to his actual possession and control.
        - This argument put forward by the registrar was aligned with the Oklahoma theory that oil and gas is similar to wild animals, and that they are not owned until reduced to possession
    - **Response of the Court:**
        - The SK court looked at the Mines and Minerals Act and the Mineral Taxation Act. No statute existed that narrowed the definition of "mineral". Mineral is broadly defined, and Land Titles Act contemplates that you can issue a title for minerals or any mineral.
            - Ordinarily construed, oil and gas are included in the definition of a mineral
            - An interest in minerals can be registered
        - As long as oil and gas remain in the earth, they are an interest in land and belong to the owner of the surface unless excepted from his title, and he may transfer ownership just as in the case of other minerals
- **Holding**

- If you owned land, you owned the 'column' underneath the land (giant carrot except for gold and silver). Accordingly, you can transfer the surface, minerals, coal, etc.

- **Ratio**
  - Oil and natural gas are "minerals" for the purpose of the *Land Titles Act* and therefore so long as they remain in the earth, they are an interest in land and belong to the owner of the surface **unless** excepted from her title, and she may transfer ownership just as in the case of other minerals.
  - Interest in oil and gas can be registered and the title can be conveyed as a profit a prendre (a right to work)
- **Notes**
  - ***Facts*: Master of Titles refused to register a transfer of "petroleum and natural gas and all related hydrocarbons except coal and valuable stone" from Landowners Mutual to Keystone Petroleum Ltd.**
    - Master: "This is not an interest in land that can be transferred; you don't have sufficient interest in the land to perfect a transaction"
  - Companies appeal this
  - ***Issue*: Is this an interest in land that can be transferred? (note: only interests in land can be registered) (pp 43-44)**
  - **"Fugitive and vagrant in their habits"**
  - At the time, ***Land Titles Act* defines "land" and "transfer" but not "mineral"? What does the common law say?**
  - **What definitions does the court look to?**
    - They look to dictionaries – ordinary meaning
    - Previous interpretations from Common Law
  - Ultimately overturns Master's refusal, but strike the "related hydrocarbons" part
  - **Key Takeaways**
    - Oil/gas qualify as minerals for the purposes of the *Land Titles Act*
    - When in the ground, it belongs to the surface owner (unless excluded from title)
      - E.g. Reserved to the Crown, split ownership (someone owns surface title and someone else has mineral title)
    - Ownership can be registered and conveyed (transferred) just like any other mineral
    - Limit on fractional transfers (1/20th)
      - 1/20 is the lowest fractional transfer
      - Here, it was ¼ which is okay
    - Be clear in your drafting – court removes reference to "related hydrocarbons"

What Our Current Statutes Say

- ***Land Titles Act***
  - Under s. 1(m) – description of land
    - (m) "land" means land, messuages, tenements and hereditaments, corporeal and incorporeal, of every nature and description, and every estate or interest therein, whether the estate or interest is legal or equitable, together with paths, passages, ways, watercourses, liberties, privileges and easements appertaining thereto and trees and timber thereon, and mines, minerals and quarries thereon or thereunder lying or being, unless any of them are specially excepted
      - Mines and minerals constitute part of the land
  - S. 52 – Undivided fractional interest in minerals
    - The Registrar may refuse to accept for registration any instrument transferring, encumbering, charging or otherwise disposing of an undivided fractional interest in a parcel of land containing mines and minerals, or any mineral, and being less than an undivided 1/20 of the whole interest in mines or minerals, or in any mineral contained in that parcel of land.
      - Follows the same limit of 1/20 from ***Landowners Mutual***
- ***Law of Property Act***
  - Under s. 79, we have statutory interpretation of a mineral lease
    - It is hereby declared that the term "lease" as used in the Land Titles Act and any Act for which the Land Titles Act was substituted includes, and is deemed to have included, an agreement whereby an owner of an estate or interest in a mineral within, on or under any land for which a certificate of title has been granted under the Land Titles Act or any Act for which the Land Titles Act was substituted, demises or grants or purports to demise or grant to another person a right to take or remove any of the mineral for a term certain or for a term certain coupled with a right subsequently to remove any of the mineral so long as it is being produced from the land within, on or under which that mineral is situated.
      - Can get a mineral lease that qualifies as an actual lease
        - Need to look at the specific statutory instrument in question
- ***Mines & Minerals Act***
  - Under 1(1)(p), we get a definition of minerals

        - Includes petroleum, oil, bitumen sands, oil sands, natural gas, coal
        - One issue we see come up is what is the difference between oil and petroleum?
    - Notice CBM and shale gas were missing from 1(1), so there is now an amendment:
        - 10.1(1) Coalbed methane is hereby declared to be and at all times to have been natural gas.

Persistent Problem

- **The existence of a registerable interest does not allow you to exert exclusive possession until the substance is obtained at the surface**
    - **i.e., You can drain a reservoir that extends under/into a region "owned" by your neighbour**
- **This can destroy the reservoir prematurely**
    - Leads to a "rush" to extract anything that you can tap into from the surface of your own land – will try to beat your neighbour
    - But if you tap a reservoir from many locations, you lose the natural pressure in the reservoir, and make it non-economical to extract the entirety of the reserve because pressure is lost
    - Artificial pressure must be applied, making the extraction costlier

Alberta's Regulatory Response? *Oil and Gas Conservation Act (+ Associated Oil and Gas Conservation Rules*)

- **Section 4 ("purposes") –** Objectives of the regulatory framework
    - (a) – To effect the **conservation** of, and to prevent the waste of, the O/G resources of AB
        - "Conservation" = Want to extract as much as possible in an efficient way (i.e. spindle top scenario/artificial collapse)
    - (b) – To secure the observance of **safe and efficient practices** in the locating, spacing, drilling, equipping, completing, reworking, testing, operating, maintenance, repair, suspension and abandonment of wells and in operations for the production of O/G
        - Essentially says that the province can tell a property owner where to drill a well
        - Want safe and orderly practices
    - (c) – To provide for the **economic, orderly and efficient development** in the **public interest** of the O/G resources of AB
        - "Public interest" = Safe practices/use, maximizing return from the resource
    - (d) – To afford each owner **the opportunity** of obtaining the owner's share of the production of O/G from any pool
        - Allows each property owner to his piece of the pie (target areas also achieve this purpose)
    - (e) – To provide for the recording and the timely and useful dissemination of information regarding O/G resources in AB
    - (f) – To control **pollution** above, at or below the surface in the drilling of wells and in operations for the production of O/G and in other operations over which the Board has jurisdiction
- **Achieving purposes?**
    - Licenses – ss. 11, 12, 15, 16
        - Section 11 – Before you can commence drilling, you need a license
        - Section 12 – For a facility used for o/g development
        - Section 15 – Application for license
            - Who is the regulator for o/g in AB: AER
                - The AER is also tasked with implementing regulations and guidelines that give effect to purposes of this Act
        - Section 15(3) – How regulator is going to achieve this – drilling/spacing units
        - Section 16 – Prescription of holding a license and process of applying
    - Restrictions – ss. 34, 36
        - Section 34 – Board of AER; regulator can limit extraction from existing reservoirs → this is for LT health of the reservoir
        - Section 36 – Gas can also be limited as it's being extracted
    - Waste Prevention – s. 38
        - Gives regulator broad scope to prevent waste
        - Waste = disposing of substances
    - Scheme Approvals – s. 39
        - If there are going to be variations sought, they have to make an application to the regulator for justification for varying from standard practices
- **What is a DSU?**
    - **Spacing unit –** unit where drilling will be permitted to access a certain reservoir

        - The purpose is to allow for the efficient recovery of oil remember
    - Ss. 4.010(1) & 4.021(1) of *OGCR (Oil and Gas Conservation Rules)*
        - Section 4.010
            - (1) – DSU for a well is the surface area of the drilling spacing unit and
                - (a) The vertical area beneath that area
                - (b) Where the DSU is prescribed with respect to a specified pool, geological formation, member or zone, the pool, geological formation, member or zone vertically beneath that areas
            - (3) – Unless the Regulator otherwise prescribes under section 4.040, the surface area of a DSU for
                - An oil well is ¼ section (4 legal subdivisions)
                - A gas well is 1 section (16 legal subdivisions)
        - 4.021
            - (1) – Unless the Regulator otherwise prescribes under s. 4.040, in a DSU
                - (a) 2 gas wells may be produced from each gas pool with the exception of
                    - (i), (ii), (iii) – large portions of AB are excluded
                        - When talking about CBM and shale gas, there are very limited restrictions
                - (b) Large portions of AB allow for 2 wells per unit
            - (2) – You need common ownership
    - **Original Presumptive Rule**: One gas well/section; one oil well/¼ section – largely a myth because of new **density drilling rules**
        - On a map, you can see this presumptive rule has been set aside many times
    - Note: Tight gas excluded; large swaths for gas production have had the DSU altered (Mannville Group/Smoky Group; i.e., 2 Wells/DSU in Mannville Group)
        - Drilling for tight gas requires precision long vertical wells as the gas is usually found in narrow, cylindrical formations
    - Note: s. 15(3) of *OGCA &* s. 4.021(2) of *OGCR*
        - There must be **common ownership** throughout the drilling spacing unit before you can have a licence to begin drilling
            - This is critical
            - How often do you have common ownership over a bunch of legal subdivisions or sections: Not often
    - Note: Special Drilling-Spacing Units (s. 4.040(1))
        - Reg. 4.040: The board **cannot reduce the size of the spacing unit unless** the applicant shows that
            - 1. Improved recovery will be obtained,
            - 2. Additional wells are necessary to provide capacity to drain the pool at a reasonable rate that will not adversely affect the recovery from the pool
            - 3. The DSU would be in a pool in a substantial part of which there are DSUs of such reduced size; OR
            - 4. If in a gas field, increased deliverability is a possibility.
        - These are technical criteria and the onus is on the applicant.
- **What is a Target Area?**
    - Marks where within a DSU, the well must "bottom out"
        - "Bottom out" = where actual extraction is occurring from
        - The target area isn't that interested where the surface structure is, but where the actual perforation is happening
        - Purpose: Maintains approximately equal spacing between wells, prevents clustering of wells
            - Target Areas promote:
                - (1) Equitable withdrawals, and
                - (2) Reduces drainage across lease lines
    - Pre-1981
        - For Oil, centre of ¼ Section
        - For Gas the 4 Interior LSD's (legal subdivisions)
    - After 1981 – 2011: based on agricultural lands v. settled lands
- **Target Areas Since 2011:**
    - Oil Wells: At Least 100m from all Boundaries of DSU (800 metres x 800 metres)
        - It makes a smaller box within the DSU for it to bottom out on
    - Gas Wells: At Least 150m from all Boundaries of DSU (1600 metres x 1600 metres)
    - Penalty for missing: 4.060
        - Ability for regulator to prescribe a penalty for missing target area
- **What is Pooling?**

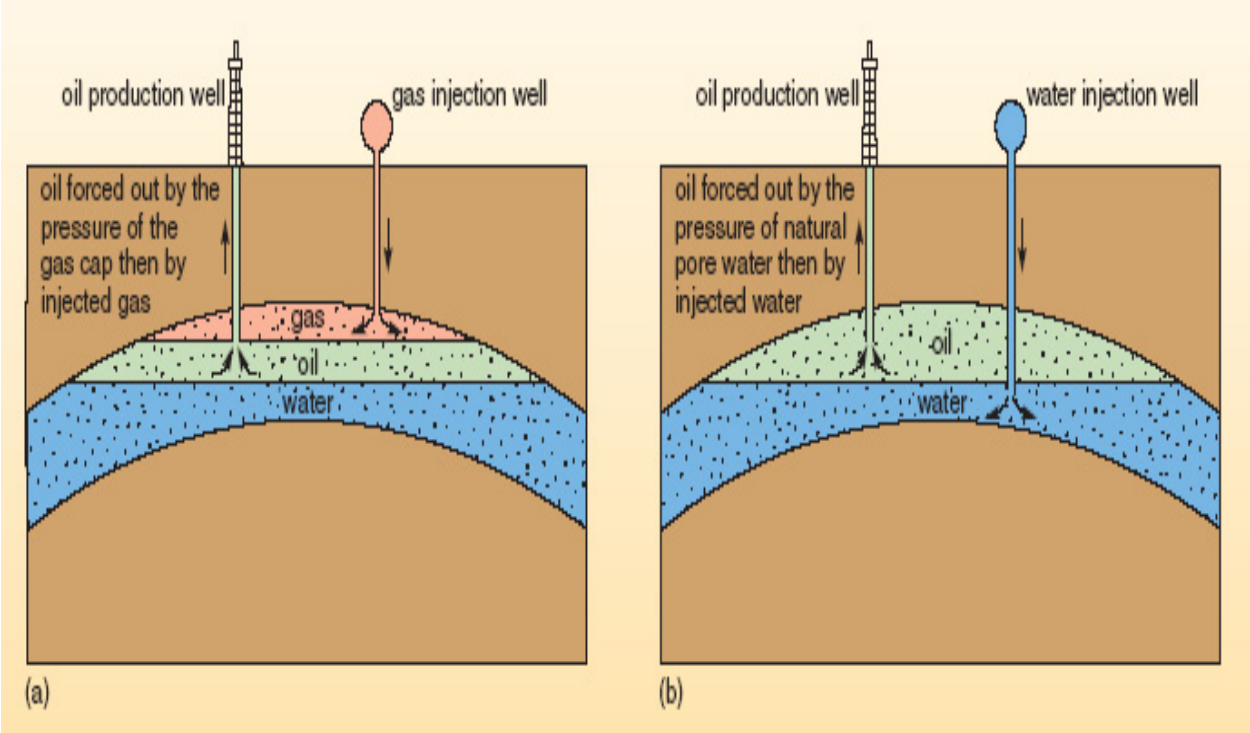
- Response to the problem of needing ownership rights for the entire DSU to get the license (i.e., s. 4.021(2))
    - Remember you need common ownership throughout the DSU to make an application to drilling
- Definition = Combining tracts of land to form a DSU
- Can be *voluntary* or *compulsory* (ss. 80-84 of *OGCA*) in AB
    - **Voluntary** – Where the owners of tracts within a DSU enter into an agreement to give the rights to one of the owners in exchange for a percentage of the oil and gas
        - Allocation of production of each tract based on percentage, and then they get that percentage back as a return
    - **Compulsory** – Used when voluntary pooling fails due to a holdout. The owner of a tract within a DSU may apply to the Board/Regulator for an order that all tracts within the DSU be operated as a unit to permit the drilling/production of oil and gas from the DSU
        - You apply for an order allowing all the tracts of land to operates as a single unit
        - Need to prove
            - Evidence agreement couldn't be struck between the owners on reasonable terms
            - Evidence on what the proportionate distributions should be between owners – default will be an area-based percentage
- Allocation of production to each tract on the basis of area (i.e., % of the pool)

- **What is Unitization?**
    - Response to the situation where there are multiple DSUs in close proximity to one another draining from the same pool
    - Definition = Unitization (*Unit Agreement*) involves the combination of DSUs to form a field for production; done to efficiently exploit the resource. Generally, each player receives a proportional share of production
        - Each landowner gets paid according to their production.
        - The agreement states how the resource can be exploited, the drain rates/lengths of time that the different wells can be operated, and how each is to be compensated (usually proportional)
    - Amount of money set by a "participation factor", which is a detailed contractual term
    - Unit Agreements have to be filed with the AER
    - **Voluntary** only (although it is encouraged, s. 79(1) *OGCA*)
    - Usual practice is that unitization can be achieved
    - Example: *Prism Petroleum* case

Indirect Monopolization and Fair Access

- **Example:** A company has a direct link from its well to an oil refinery. They are capable of producing at a faster rate than smaller producers who have adjacent leases. It is true that everyone can drill a well, but it is not true that everyone can get their share of the common pool
    - You may also have certain transporting companies that only service certain oil extracting companies, giving an advantage to those certain producers and not others
- **Solution:** Access to transportation (common carrier orders), refining facilities (common purchaser orders) and processing facilities (common processor orders) resolve the problem of indirect monopolization.
- **Common Carrier Orders (pipeline capacity) –** ss. 48 & 49 of *OGCA*
    - **Rule:** You cannot deny service to any customer if the customer is willing to pay the established price
    - An application can be made to the Board to have a pipeline declared a common carrier.
        - As a result, no proprietor of a common carrier can allow any discrimination of any kind against any person attempting to have oil or gas transported (s.48)
            - Only permitted discrimination/exception: if the oil and gas is of **inferior** quality/composition
        - They cannot prioritize their own interests (s.48(3))
        - Cannot discriminate against someone who transports their oil through the pipeline
        - Cannot discriminate with their own product at the expense of others who wish to use the pipeline
        - Cannot discriminate in price or capacity
- **Common Purchaser Orders (equal market access) –** ss. 50-52 of *OGCA*
    - Applies to any party who purchases, produces, or otherwise acquires oil produced from any pool in AB (a refinery)
    - An application can be made to declare a party as a common purchaser
        - In other words, a refinery can be deemed a common purchaser, which means that they must purchase all oil offered for sale to it without any discrimination (s.50)
    - The only ability of a common purchaser is to deny purchase on the basis of inferior or different quality/composition (s.52)
- **Common Processor Orders (processing/refining capacity) –** ss. 53 & 54 of *OGCA*
    - The owner/operator of a processing plant can be deemed a common processor, in which case they must process all gas brought forward without discrimination (s.53)
    - The only relief afforded to a common purchaser is on the basis of inferior or different quality/composition (s.54)

Typical Oil/Gas Reservoir



- **Free gas (gas cap)**
  - Gas phase hydrocarbons that are on top of the reservoir – remain a gaseous state
  - One of the benefits – provide lift during the recovery process (helps lift the oil by applying a downward pressure)
- **Oil reservoir**
  - In situ, this layer is in liquid phase
- **Mixed reservoir (solution gas and evolved gas)**
  - **Solution gas/associated gas:** You are going to have a certain amount of gas in the liquid in situ; however, when recovered/you bring it out of the ground, it emerges as a gas because the pressure has changed at the surface
  - **Evolved gas/secondary gas cap**: It is liquid in situ temperature and pressure, but upon initial perforation (with change in pressure from initial penetration of reservoir), it bubbles out of the oil liquid layer and joins the gas cap
- **Connate water (dissolved gas)**
  - Heavy stuff at the bottom
  - Briney, salty – has minerals from sedimentation in it
  - There is also gas dissolved here too; this is unresolved in terms of ownership
  - Sometimes it's in the pore space in the rock, sometimes it's in its own aquifer basin
  - Water belongs to the provincial crown
- There is a variety of ways you can split title
  - Problem though when you split title: who owns what?

Borys v Imperial Oil (1953 UKHL) – Petroleum Meaning By Vernacular Test; Does Not Include NG; CPR Had Right to Petroleum and Right to Extract; NG Interest By Borys But Could Not Deny CPR's Extraction; Implied Right to Work and Produce the Product, Despite Issue Wasting Other Substance

- **Facts**
  - Borys acquired land in fee simple that had the following reservation on title: "all coal, petroleum, and valuable stone."
    - This reservation was in favour of CPR who, in reliance of this reservation, leased to Imperial Oil all petroleum that might be found within, upon, or under the said land.
  - The problem arises because above the petroleum is a layer of natural gas, which Borys claims is his
    - Borys believes that natural gas was not included in the term "petroleum" found in the reservation, and accordingly that he was entitled to it.
  - Problem is complicated further because the NG, once recovered, will be mixed with the petroleum (pressure change causes some NG to turn from liquid to vapor form).

- Borys sought a declaration of his ownership; he also sought injunction against Imperial Oil or damages, in the alternative
- At trial, it was held
  - (1) That petroleum and natural gas are two separate substances;
  - (2) That the appellant (Borys) was the owner of all such gas whether free or in solution;
  - (3) That Imperial's workings would interfere with his rights, and granted a permanent injunction.
- On appeal to the Supreme Court of Alberta
  - Court agreed that petroleum and natural gas were two different substances, but held:
    - (1) That gas in solution in strata in liquid form in the petroleum was part of the petroleum and was therefore one of the products reserved under the lease;
    - (2) That the reservation of the substance included a right to work it;
    - (3) That all petroleum reserved is the property of the respondents (Imperial) and all gas not included in the reservation is the property of the appellant (Borys); and
    - (4) That Imperial was entitled to extract all of the substances belonging to them from the earth even if their action caused interference with and wastage of the gas belonging to the appellant

- **Issue**
  - Who owns the NG beneath Borys' land?
- **Analysis**
  - **Vernacular Approach:**
    - The court determined that **petroleum**, with a non-scientific interpretation **(vernacular test)**, meant only a substance in **liquid** form.
    - The approach looked to what the intention of the contracting parties was **at the time of the grant/land transfer**
      - Expression is to be determined based on the vernacular of the mining world, the commercial world and landowners at the time when the grant is made
    - Natural gas was a vapor and not included in the definition of petroleum.
      - When the gas was dissolved in solution, it would however be included within the definition of petroleum and belong to the petroleum owner
  - The court had no difficulty accepting that the NG *in situ* belonged to Borys because it was not included in the reservation.
    - This was found despite the fact that a key feature of ownership, possession, is not found – interest was a profit a prendre
  - **Permitted waste**
    - Imperial Oil has a direct grant to the petroleum, and they are not under an obligation to conserve Borys' natural gas
      - A reservation by a landowner of the mines and minerals or, indeed, in specific terms, of petroleum, is meaningless unless it is accompanied by the right to work and to recover the substance reserved.
    - The petroleum owner is permitted to remove the product from the reservoir and waste other resources lost in the extraction even though they may belong to the surface owner
  - **When to apply distinction of petroleum from gas and determine ownership based on concerning the phase of petroleum/natural gas** – three possibilities:
    - **<u>Condition within the reservoir</u>** — what was the distribution of substance prior to production?
      - This was the application chosen by the Court in ***Borys***
    - **Condition in which the substances enters the well bore** — what condition does the substance enter the well for production?
    - **Condition in which it arrives at the surface** (determined by carbon content) — what is the condition when it reaches the well head?
      - This would typically yield more vapour NG
- **Holding**
  - The gas whilst in situ is the property of the appellant (Borys) even though it has not been reduced into possession; Borys can recover the NG by any usual and customary manner, but cannot prevent Imperial Oil from following a similar course
  - Appeal dismissed
- **Ratio**
  - "Petroleum" owner is entitled to the liquid hydrocarbons in the pool/reservoir
    - Determined through a vernacular test, not a scientific definition
  - Phase-based ownership determination is to be made while the resource is in the ground
  - The petroleum reservation includes an implied right to work and produce the product – limits?
    - Despite issues with waste of natural gas
    - Limits?
      - Destruction of the surface
      - Right has to be exercised in a reasonable manner
  - Ownership determination is made at the time of contracting
  - Vernacular (not scientific) interpretation of resources
    - Natural gas is not included in the definition of "petroleum"
  - The gas whilst in situ is the property of the surface owner even though it has not been reduced into possession, as long as it was not reserved on title
- **Notes**
  - **Facts – pp. 46-47; "all coal, petroleum, and valuable stone" reserved by CPR in original transfer**

        - B owns surface
        - CPR had reserved all coal, petroleum, and valuable stone
        - B takes the position they own the gas since this doesn't fit within the reservation
        - CPR leases to Imperial all petroleum and the right to work the petroleum for 10 years, with a renewal option
            - Court called this a *profit a prendre* (exclusive right to work and win the resources)
        - Imperial starts developing
            - B: You're taking my gas cap
            - I: We have a right to exploit; profit a prendre comes with an implied right to work at common law, which includes surface disruption; otherwise you'd sterilize resource development
        - B: I have the right to both the gas cap and the solution gas, and you are interfering with my right to the property (B wants compensation)
        - B initiates an action to get a declaration of ownership
    - **Issue(s) – p. 47**
        - What is included in the petroleum reservation?
            - Is it only the liquid oil, or liquid oil + dissolved gas in situ?
        - When do we make this determination and at what location (surface or below for example)?
    - **Results – trial, appeal, House of Lords – p. 47**
    - **Reasoning**
        - Approach to understanding different resources
            - Ordinary meaning of the term
            - Scientific meaning
        - Court looks at the ordinary meaning
            - This is problem #1 – we're dealing with a very scientific area yet we're taking a vernacular approach
            - Ordinary meaning of petroleum: liquid hydrocarbon in situ
        - Temporally, what does the court choose as the moment for making a distinction?
            - Court prefers it in situ at the time of contract/agreement was formed
                - Borys' gas is limited to just the free gas in the gas cap
        - Imperial: We have an implied right to work
        - B and Imperial strike an agreement: B gets a 2.5% royalty on the oil that is produced; this royalty will compensate for the gas that is being impacted via the process of development
    - **(Unexpected) lasting importance of this decision**
        - It was in reference to very particular facts; however, the Court uses ***Borys*** in novel circumstances (*it wasn't meant to be like this important of a case though likely*)

Problems with the Typical Reservoir

- **Upon reservoir penetration & development the ratio of oil to gas changes**
- **Difficult to determine how much gas is from the gas cap and how much is solution gas/evolved gas**
- ***Borys*: Must determine who owns the gas?**
- **Legislated response to *Borys* and the implied right to work/enter land to secure production**

5. Surface Access

The Problem of Surface Access

- **"As Canadians, we think we have property rights because it is a natural thing to assume in a democratic nation. Property ownership is a gauge of our security and a storehouse for our savings."**
- **Professors Eran Kaplinsky and David Percy, authors of the Alberta Land Institute's *A Guide to Property Rights in Alberta*, describe assumptions that we make about the property we own…" "…that we will be able to use it and enjoy it, develop it as we desire, exclude others from it and sell it to whomever we please. *But in Canada the ultimate right over property belongs to the Crown*. The government can do with our property more or less as it pleases."**

Cabre Exploration Ltd v Arndt (1986 AB) – Implied Right of Entry Arises at Common Law with Severance of Mineral Title from Surface Title (This is Now Changed by the *Surface Rights Act*)

- **Analysis**
    - At common law, upon the severance of the title to the minerals from the title to the surface, a right of entry arose at law (a natural easement)
        - The only limits on the common law right of access:
            - Limit to the amount of damage and disturbance which the surface owner was bound to suffer.
            - That limit was that a mineral owner was not entitled to cause subsidence of the land, nor generally to deny the surface owner's right to support.

    - No party would purchase a severed title to mines and minerals that was not accompanied by a right to work the minerals
- **Ratio**
    - Upon the severance of the title to the minerals from the title to the surface, a right of entry arises at common law; the surface owner's permission is not required.
- **Note**
    - This is fixed/changed by the *Surface Rights Act*, below
        - The operator is required to pay the landowner for the right of entry and user as if the right were taken from the landowner
- **Court of Appeal**
    - Court recognized that the *SRA* creates a notional taking in Alberta, meaning that the operator must **pay** for the surface access to be able to extract the minerals

Response: The *Surface Rights Act* – Changing the Common Law Approach

- **Right of entry**
    - **Section 12(1)** No operator has a right of entry with respect to the surface of any land
        - (a)-(e)

      …until the operator has obtained the consent of the owner **AND** the occupant of the surface of the land **OR** has become entitled to right of entry by reason of an order of the Board pursuant to the act
        - **5 situations where the SRB will grant access, if access by surface owner or occupant is refused (as per s. 12(1)):**
            - **1.** Recovery of Minerals
            - **2.** Construction of tanks, stations and structures in connection with a mining or drilling operation
            - **3.** Pipelines
            - **4.** Power transmission line
            - **5.** Telephone line
        - The Act only applies to these 5 cases to compel access
        - Nowhere does it say that you can have access for mine and mineral *exploration* (which is odd since you had this right at common law)
    - **Section 12(2)** – Separate Sum for Surface Access
        - Operator must provide compensation separate from the price they paid for mineral or petroleum rights to be able to receive surface access in order to work the land and extract the resource
    - Orders
        - **Section 15** – Process to make an application
            - (2) Board will look at the reasonableness of the offer to see why an agreement couldn't have been reached before an application was made
            - (6) The Board can make an order (see ***Encana Corp***)
                - Application for a right of entry order here arises only where the owner won't consent to the operator entering the owner's land
        - **Section 16** – Actual order the Board can make
            - Gives the operator the right to enter
    - Compensation provisions
        - **Section 19** – The first form of compensation for the owner is going to be an entry sum
            - Certain amount of money that is the lesser of $5000 or $500/acre
        - **Sections 23-25** – The Board can craft the compensation scheme
            - 23 – Board only grants a right of entry in exchange for compensation
            - 25 – Which is determined based on the market value of the land and other factors

Encana Corp v Campbell (2008 ABQB) – SRB Can Grant Right of Entry Subject to Conditions as Long as Conditions are Not Inconsistent with the License Granted to the Licensee; S. 15(6) of the *SRA*

- **Analysis**
    - An application for a right of entry order under s. 15(6) arises where the owner will not consent to the operator entering onto the owner's land.
        - Designed to ensure the SRB balances the landowner's concerns against the operator's need to enter onto those lands
    - S. 15(6) of the SRA allows the Board to grant a right of entry onto certain lands, along with conditions to that entry, so long as the conditions imposed are not inconsistent with the license granted to the licensee

        - SRB cannot exercise jurisdiction to deny entry to the well site so as to frustrate the license—right of entry order must be granted
        - Suggests that the AER license takes priority
    - Statutory intervention is there to relieve the harshness of the common law; the scheme is there to right that wrong by allowing negotiations to occur, intervening if they don't occur, and compensating the surface owner for a disruption that's happening

6. Solution and Evolved Gas

Prism Petroleum Ltd v Omega Hydrocarbons Ltd (1994 ABCA) – Ownership of Liquid Oil vs Solution Gas; Point in Time and Location of Ownership Definition; Followed *Borys*

- **Background**
    - Prism (the appellants) entered into a unitization agreement for the West Provost Viking Gas Unit.
    - Omega (the respondent) has two operating oil units within the boundaries of the gas unit.
    - The unitization agreement includes:
        - Petroleum substances and all fluid hydrocarbons not defined as oil – everything except oil
        - Oil is defined as "crude oil and all other hydrocarbons regardless of gravity that are or can be **recovered in liquid form** from the unitized zone through a well by ordinary crude oil production methods." – so it is owned by Omega
            - If recovered as a vapour, then it belongs to gas owner—Prism
        - Note on unitization:
            - Unit agreement agree to pool their lands in the unit in exchange for a share of the production to which they are entitled from all the lands in the unit.
- **Facts**
    - Omega acquired its oil rights after the unitization agreement was in effect.
        - This means that the initial registered owners or lessee's from the registered owners could only convey to Omega those rights that were not already conveyed to Prism.
    - Omega started producing oil in the unitized zone and drilled 17 producing wells.
    - Prism sought, inter alia, an order declaring their ownership of the solution gas, an accounting, interest and damages for wrongful conversion
    - The trial judge concluded that the solution gas belonged to the appellants (Prism) and not Omega by virtue of the interpretation placed by him on the relevant unitized agreements
        - Although apparently successful at trial on the entitlement issue, the appellants faced a substantial monetary judgment and thus were motivated to appeal.
        - On the other hand, the respondent, Omega, was rewarded at trial with a substantial monetary award but lost entitlement to a most valuable hydrocarbon.
- **Issue**
    - Ownership of solution gas produced, with oil, from wells drilled by the respondent?
    - Is Omega violating anyone's rights by producing gas along with its oil?
- **Analysis**
    - The gas at the heart of this dispute is **solution gas,** which emerges at the wellhead as a vapour but is in liquid form in the reservoir.
        - Thus the issue is reduced to whether the plain words of the definition related to surface or reservoir conditions;
        - Whether ownership of the resources will be strictly determined based on the time of the conveyance and the state of the resources while in the reservoir
    - Once the case is characterized as a solution gas case, it follows that the great temptation is to apply ***Borys,*** and to therefore hold that Omega as the petroleum owner can take the solution gas (because the gas was in liquid state in the reservoir).
        - ***BUT, remember: Borys*** *was not a case of general application, it held that the ordinary meaning of petroleum at the time of the land transfer between CPR and Borys included all hydrocarbon liquid substances in the reservoir*
    - The Court nevertheless followed ***Borys*** and said that because there is not a test for determining the nature of ownership of a substance at the surface, then we **must look at the reservoir conditions**.
        - Therefore, the solution gas belongs to Omega
- **Holding**
    - Appeal allowed; the solution gas belonged to Omega because it was in liquid state in the reservoir (so the Court followed ***Borys***)
- **Ratio**
    - Solution gas is part of petroleum recovered from well (belongs to oil producer)
    - "Point of recovery' focuses on reservoir conditions
- **Notes**

- What distinguishes this from ***Borys*** – unitization agreement
  - In ***Borys***, we were looking at a reservation
  - Here, there is a gas unitization agreement (bringing DSUs together to form a field of development)
- **Contest over ownership of solution gas (defined on p. 54, as understood in Gas Unit Agreement)**
  - Here, the agreement defines petroleum substances slightly differently than what you see in ***Borys***
    - 'Petroleum Substances' means natural gas produced from the Viking Member of the Colorado Formation both before and after it has been subjected to any processing, and includes all fluid hydrocarbons not defined as 'Oil', that are capable of being produced from the Viking Member of the Colorado Formation
    - 'Oil' means crude oil and all other hydrocarbons regardless of gravity that are or can be recovered in liquid form from the Unitized Zone through a well by ordinary crude oil production methods;
- **Cause of action (p. 55)**
  - By gas producers (Prism) – asserting ownership of solution gas, asserting accounting and interest for solution gas that has been produced by Omega; also seeking general damages for wrongful conversion
- **Result – solution gas included in definition of "oil"**
  - Court: Omega gets what is left over
    - Omega is producing oil, and in the process, they're producing solution gas
      - Gas producers: "This should be our gas"
  - Court: Look at ***Borys***
- **Reasoning and application of *Borys* (pp. 56 and 57)**
  - Focus on reservoir conditions opposed to surface conditions
  - Application of plain words to discover meaning
  - Recovery occurs at the bottom of the well-bore hole, not at the surface

Anderson v Amoco Canada Oil and Gas (2004 SCC) – Evolved Gas; Hydrocarbon Entitlement Determined by Phase at the time of Transaction, Meaning Initial Reservoir Conditions

- **Background**
  - In 1904, CPR recognized the inherent underground value of the land they owned. As a result, they began to reserve valuable subsurface minerals from title when they sold the land. Initially, they only reserved coal but by 1912 they were reserving rights to all M&M. CPR then entered into agreements with settlers for the transfer of title to this land. Under these agreements, CPR reserved its right to petroleum, creating split title lands.
- **Facts**
  - In this case, the appellants were owners of NG and argued that ownership of NG should be determined at the time the hydrocarbons enter the bottom of the well head
    - The appellants tried to show that there was a developed theory of OG ownership → that evolved gas belongs to the gas owners since "Canada is not an *in situ* ownership jurisdiction."
  - The petroleum owners (respondents) argued that ownership should be determined according to original reservoir conditions – prior to human intervention
    - This would include evolved gas as it is liquid in initial reservoir conditions
  - TJ
    - Fruman J found the non-petroleum owners were entitled to:
      - 1) Primary gas cap gas;
      - 2) Primary gas cap gas which migrates from adjoining lands;
      - 3) Condensate and natural gas liquids that derive from primary gas cap gas.
    - Petroleum owners were entitled to:
      - 1) Evolved gas;
      - 2) Secondary gas cap gas which migrates from adjoining lands;
      - 3) Solution gas that emerges from connate water; and
      - 4) Condensate and natural gas liquids that derive from secondary gas cap gas
  - Court of Appeal
    - Dismissed the appeal except to the extent they did not agree that the petroleum owner was entitled to the gas from connate water
- **Issue**
  - What is included in a reservation of oil, and at what point in time should the determination be made?
    - In other words, did the ***Borys*** decision pertain to original reservoir conditions or the condition of the hydrocarbons arriving at the wellhead?
- **Analysis**
  - **Result:**
    - a) The petroleum owner is entitled to all hydrocarbons which were in liquid phase at initial pool conditions, regardless of the phase they are in when recovered.
    - b) The non-petroleum owner is entitled to all hydrocarbons which were in gas phase at initial pool conditions, regardless of the phase they are in at time of recovery.

- **Appropriate time to determine what phase a molecule of hydrocarbon was in and to whom it belonged**
    - Point in time is important because once a reservoir is perforated, the pressure in the reservoir changes (usually decreasing), creating evolved gas (gas previously held in liquid becomes gaseous)
        - Also, there is some gas existing as liquid in the reservoir that becomes gas at the surface (solution gas)
    - SCC applied ***Borys*** and confirmed ***Prism*** to find that hydrocarbon entitlement is determined according to **phase at the time of transaction**, which in most cases means **initial reservoir conditions.**
        - Phase changes that occur once a pool is drilled into do not affect the ratio of hydrocarbons the petroleum owner and the non-petroleum owner are entitled to
    - This was practical because ownership would be under constant change as pressure constantly decreases.
    - It is relatively easy to determine oil to gas ratio at time of transaction using expert reports.
    - This also fits the logic of ***Borys***, as we must look at the vernacular (layman's definition) at the time of the grant.
- ***Borys*** is basically being evolved to a principle of interpretation to a rule of law.
    - Courts now have a tendency to apply ***Borys*** to a wide variety of litigation.
- **Problem:** The boundaries of this case have been decided by the previous two cases. If the court in ***Prism*** intended to treat evolved gas differently than solution gas, they would have done so
    - **Ownership theory is skirted,**
        - i.e. It would make no sense to say that a substance with the same molecular structure (hydrocarbon) would change ownership upon a change in *phase.*
        - This is like saying that ownership of water changes when it becomes steam
- **Connate gas:** Gas which emerges with connate water does not belong to the petroleum owner.
    - Court of Appeal seemed to hint that under the Water Act, all water in AB belongs to the Crown.
        - This implies a third owner of substances in the reservoir, which causes obvious problems but has been ignored
    - Implies that since the Crown owns the water, they own the gas that is contained in the water
    - Unclear who owns connate gas; we know it doesn't belong to the petroleum owners, likely the gas owners.

- **Holding**
    - **The reservation of petroleum includes all hydrocarbons which were in liquid phase in the ground at the time of the transaction** (i.e. at the time the lease was signed, or at original pool conditions, NOT at the bottom of the wellbore)
    - Appeal dismissed
- **Ratio**
    - Ownership interest in oil and gas determined on the basis of the phase the hydrocarbon was in under initial conditions at the time of the contract for the sale of the property.
        - Any phase changes which occur after the well is drilled into a pool does not alter the ratio of ownership created by the reservation
- **Notes**
    - **CPR context**
        - Started to split title
    - **Brings the historical *Borys* decision into the world of evolved gas and settled the final outstanding dispute**
        - Petroleum reservation includes all liquid HCs at the point of transaction
        - Who gets the evolved gas then?
            - The petroleum owner
    - **What does a petroleum owner get? What does a non-petroleum owner get?**
        - Petroleum owner seems to get everything at liquid phase at time of transaction/initial reservoir conditions

Ownership of Split Title Lands – Summary

- **Petroleum owners:** Entitled to all hydrocarbons which were in liquid phase in the ground at the time of the transaction (grant/lease), in original reservoir conditions, regardless of the phase they are in upon recovery
- **Non-petroleum owners:** Entitled to all hydrocarbons which were in a gas phase in the ground at the time of the transaction (grant/lease), regardless of the phase they are in upon recovery
    - Excluded from owning petroleum on the title by:
        - E.g. leases that gave rights away or reservations on title
- **Rule of capture**
    - The rule of capture does not apply to the division of ownership by phase as it does to divisions of ownership based on surface land ownership
    - Oil does not have to be reduced to possession to become the subject of ownership;
        - This was evident from ***Borys*** and ***Anderson*** which declared that ownership exists before the reservoir is penetrated
    - Ownership is perfected by capture at the surface, but rights holders have exclusive right to work the land for the resource
- **Connate gas**
    - The ***Anderson*** case raises it, and suggests issues
    - Arguably, the government of AB owns the connate

- ***Borys*** has frequently been reapplied, despite its limited intent for future application

7. GAS OVER BITUMEN

Alberta Energy Co v Goodwell Petroleum Corp (2003 ABCA) – Bitumen Owner has Right to Incidentally Produce NG in Bitumen Recovery Using Ordinary Reasonable Production Methods

- **Background**
  - When a gas-cap is present, it is not possible to produce bitumen without producing some initial gas-cap gas
  - Alberta Energy Utility Board (**now the AER**) takes the position that a crown oil sands lessee has no right to produce any initial gas-cap gas incidental to bitumen recovery; it requires the natural gas lessee's consent.
  - If there is no agreement, the Board believes the well license is contravened and the bitumen well may be shut in; that is what occurred in this case
- **Facts**
  - Goodwell held the petroleum and natural gas rights on five contiguous sections in the Athabasca oil sands area; AEC held the bitumen rights in these lands
  - AEC was producing the bitumen and Goodwell complained that AEC was using its NG, which it did not have a right to do in its extraction of bitumen
  - Goodwell also claimed that AEC's production had a high gas to oil ratio (describes how much gas is being produced from any type of well versus how much oil is being produced), causing a conservation issue
  - Prior to this case the EUB (now AER) had shut in AEC's four bitumen producing wells in the interests of protecting Goodwell's NG rights.
    - Bitumen wells shut in to encourage agreements to be made between the right holders until AEC has the "full rights to produce"
  - 2 key issues
    - No right to produce the gas gap held by the bitumen right holder: Goodwell argued and the EUB takes the view that the bitumen lessee does not have the right to produce any initial gas cap gas in connection with its bitumen recovery
    - Conservation issue: Goodwell also claimed that AEC was creating a conservation issue, because AEC had a disproportionately high gas-to-oil ratio in their development of bitumen
      - Issue is that the ratio might have a negative impact on the overall recovery of bitumen from that region by dropping the pressure in the bitumen site.
- **Issues**
  - To what extent can EUB shut in wells so as to prevent bitumen producers from producing gas-cap gas incidental to bitumen in a split title situation where bitumen rights and NG rights are held by different parties?
  - Does AEC's right to produce leased substances under its oil sands leases include any production of initial gas-cap gas?
- **Analysis**
  - The EUB objected on a few grounds, none of which were accepted by the court:
    - **1. *Borys* is distinguishable on scientific grounds**
      - Argument: the geological principles and extraction methods for bitumen are not sufficiently similar to petroleum to justify application of the ***Borys*** principles
      - The court said they are very **similar** processes for recovery
      - The role of initial gas-cap gas in bitumen recovery is similar to its role in conventional oil recovery.
        - Because a gas-cap is present, initial gas-cap gas pressure assists in moving the bitumen and is therefore critical to recovery, and some initial gas-cap gas is inevitably produced with the bitumen.
      - **Implied right to recover by reasonable means:** This is about two parties asserting their rights, each of whom is entitled to ordinary reasonable methods of production
    - **2. *Borys* is distinguishable on statutory grounds**
      - Argument: The M&M Act says that a person may not exploit a crown owned mineral unless authorized to do so under the Act or under a contract; therefore the bitumen owner only has a right to bitumen and not NG
      - The court said no.
        - If this were upheld we would have a hold-out problem with the NG owner because the bitumen owner would need the NG owner's permission to produce.
        - M&M Act does not take away common law rights of the mineral owner.
    - **3. *Borys* is distinguishable on contractual grounds**
      - Argument: The terms of the specific oil sands leases and related instruments override ***Borys***
      - Court: No. ***Borys*** indicates that the implied right to work/recover a mineral is not confined to reservations but applies equally to other methods by which production rights arise including crown leases.
        - Neither recovery nor removal would be possible if AEC did not have the corollary right to produce initial gas-cap gas
    - **4. The timing of the Goodwell gas lease was irrelevant**

- One argument advanced by Goodwell was that since the natural gas lease was granted before the Bitumen lease, the government incidentally could not grant a bitumen lease that would result in the production of gas cap gas.
    - This argument failed to account that a lease is a profit a prendre, meaning recovery of any substance is contingent on the effort and capital used to extract it.
    - Since AEC had the right to recover the bitumen, and the gas cap gas was a reasonable and expected consequence of this recovery, the date that the lease was granted was irrelevant.

- **Common law principles:**
    - (1) That a right to bitumen includes the right to do all things reasonably necessary to recover bitumen,
    - (2) That leases containing express powers to win, work, recover and remove a hydrocarbon should not be interpreted in a manner that nullifies these rights, and
    - (3) That because initial gas-cap gas production is a known and inevitable consequence of bitumen recovery, the right to produce initial gas-cap gas is an implied term and a natural gas lessee cannot stop recovery of bitumen by reason only of the fact that some initial gas-cap gas is incidentally produced.
- **Outcome:** What is Goodwell left with?
    - Court said that they can get compensation; EUB has an assumption that whatever is taken from the NG owner can be compensated for.
        - The gas can be measured and compensation can be paid.

- **Holding**
    - Appeal allowed; AEC's express right to win, work, recover and remove bitumen under its oil sands leases entitles it to produce initial gas-cap gas incidental to bitumen recovery using ordinary reasonable methods of production, **subject to rights Goodwell may have for compensation for the initial gas-cap gas produced**
    - The Board did not have the jurisdiction to shut in the wells on the basis that AEC did not have the right to incidentally produce natural gas while recovering bitumen
    - Court sees this dispute as being under the purview of ***Borys***
- **Ratio**
    - A company holding bitumen rights under its oil sands leases entitles it to produce initial gas-cap gas incidental to bitumen recovery using ordinary reasonable methods of production, subject to the rights of the natural gas owner for compensation for the initial gas-cap gas produced
- **Notes**
    - ***Oil Sands Conservation Act:*** **purposes**
        - Broadly analogous to OGCA purposes
    - **Petroleum & Natural Gas leased separately from oil sands/bitumen rights**
    - ***Problem*****: when a methane gas cap is present, oil sands lessee can't produce the bitumen without producing some of the gas cap.** ***Is this really problematic?***
    - **Recall *Borys*: corollary right to produce gas gap to produce petroleum so long as reasonable production methods are used**
        - AKA, this shouldn't be a problem then; as long as you can fit under the statutory scheme, you should be able to produce
    - **Goodwell Petroleum Corp (GPC) with Petroleum & NG leases in 5 contiguous sections in Athabasca**
    - **Bitumen rights held by a separate company (AEC) & a considerable amount of gas being produced. Conversion lawsuit initiated**
        - Lawsuit by oil/gas rights holders
    - **Application for shut-in of 16 horizontal wells**
        - Shut in – seal off well at the surface
    - **AER: Orders 4 wells shut-in. Why?**
        - 1) Impact on overall projected recovery (*conservation*)
        - 2) <u>NO</u> right to produce gas cap in oil sands leases *(Borys?)*
            - Note that ***Borys*** would say that this is not correct
    - **Judicial review: 1) err in not allowing *some* gas cap production; 2) err in shutting in wells until full rights possessed**
        - Therefore, they overturned the decision
    - ***Standard of review*****: Correctness**
    - ***Borys*****: Board's position seems to conflict. Board suggests it shouldn't apply to oil sands leases because of: 1) science (p. 65); 2) contracts (p. 67); and 3) statutes (p. 67)**
    - ***Court*****: "A lessee whose rights are affected by a known and inevitable consequence of the production of some other mineral cannot enjoin [prohibit by injunction] recovery of that mineral although the lessee might be entitled to compensation"**
        - *They don't really know though what kind of compensation should follow*
    - **You CAN restrict with express language**
    - **"Mineral extraction is an invasive business, likely to interfere with someone's property rights. Nevertheless, courts grant generous rights to exploit resources, even if the operators inevitably divert percolating waters, cause mines in**

higher strata to collapse and produce initial gas cap. In fact, the only prohibition seems to be against operations that completely destroy the surface of the land."

- **AEC to compensate Goodwell for its gas, although the details of this compensation are not canvassed**
- **Inappropriate shut-in order under the *OGCA* and *OSCA***

Gulf Canada Resources Limited Request for Shut-In of Associated Gas, Surmont Area **(2000 EUB) – Gas Wells Shut-In Due to Significant Risk and Not in the Public Interest**

- **Facts**
  - Gulf /Conoco had a bitumen lease from the province, and the province leased NG to other companies.
  - Gulf was concerned that the pressure depletion in the gas cap might affect bitumen recovery by SAGD (steam assisted gravity drainage) processes, so they applied to the EUB for an order to shut in associated gas production within a 3-section buffer of its leases.
  - Surmont Producers Group (SPG) objected, arguing that SAGD technology was too uncertain and that shut in is an overreaction.
  - EUB shut in 146/183 several gas wells
    - In all tar sands areas, 938 existing NG wells were shut down in fear that the NG wells threatened the ultimate recovery of bitumen.
- **SPG's Argument**
  - 1. Potential for resource sterilization is not in the public interest (s. 99 OGCA)
  - 2. It is not worth shutting in to protect a resource that has no current economic value
  - 3. There were many other bitumen areas that weren't subject to shut in
  - 4. The current market value of NG would be $190M and the cost of a shut in would be $11M to shut in the wells
- **EUB Reasoning**
  - The potential of resource sterilization is a matter in the public interest, which is part of its mandate
  - Recoverable bitumen reserves were roughly between 5.25 – 7.5 *billion* barrels whereas NG reserves were 17-32 *million* barrels; therefore, it's in the province's best interest to preserve bitumen
    - The amount of bitumen at stake in this area was very substantial
    - The Board feared that the bitumen resource would be sterilized by production of the natural gas in the area
  - It could take 200 years to produce bitumen, but it is not reasonable to force bitumen development by requiring leaseholders to demonstrate commitments to bitumen projects within a given timeframe; this would discourage investment in bitumen projects
  - The EUB was unwilling to rely on re-pressurizing depleted gas zones by gas injection, as feasibility had not yet been demonstrating.
    - The same went for re-pressuring with water
  - Metis views: Gulf bitumen developers had been more responsive and willing to hearing Metis views and concerns than the natural gas developers
- **Compensation Issue**
  - The shutting in of the resource looks like expropriation
    - But the expropriation is temporary, not permanent
    - It is a deferral of the right to develop the gas resource
  - Gulf (now Conoco) entered into the **Agreement** below
- **Notes**
  - **Gulf seeks shut-in sought for associated gas production**
  - **Gulf's leases = 5.25-7 billion barrels of recoverable oil**
  - **Recoverable gas = 32 million barrels (equivalent)**
    - Clearly a discrepancy to the oil
  - **"Reservoir modeling reasonably demonstrates that producing associated gas in the Surmount Area would likely have a detrimental effect on SAGD bitumen recovery"**
  - **Significant risk / NOT in the public interest** in allowing in gas cap recovery, because of the effect it can have on the oil sands **(*OGCA*)**
  - **Shut-in ordered for 146 of 183 requested wells**

Authorization of an Agreement Between the Crown and Conoco Canada Resources Ltd et al (OC 83/2002) – Memorandum of Understanding: Alberta/Conoco/SPG; Gas Right Holders Were Paid Compensation for Deferred Production; Will Pay Gross Overriding Royalty When Eventually Producing Gas

- **Background**
  - The province may have had a good argument that there was no right to compensation based on ***Borys*** principles and also based on the fact that there was no expropriation of production, just a delay in extraction. Had we been forced to a legal

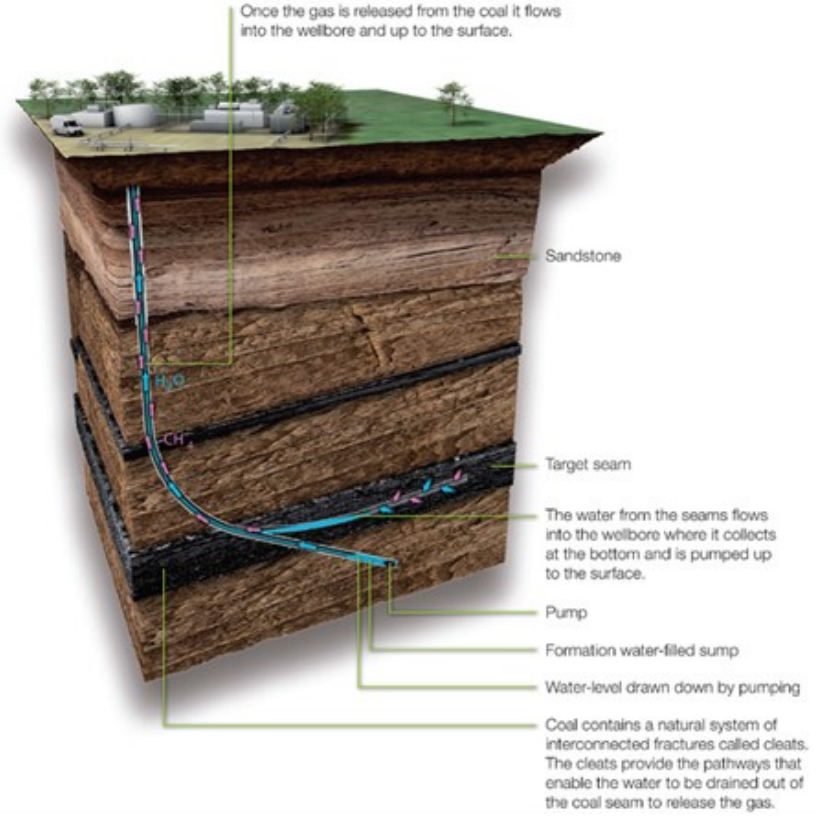
showdown, there was considerable doubt that NG owners would have any rights to compensation based on a strict interpretation of the law.
    - Politically, the NG owners have huge clout – large O/G producers carry considerable influence and to not compensate these companies would be detrimental to future investment in these companies
- **The Conflict and Resulting Agreement**
    - Conoco has benefitted hugely from the EUB decision to shut in the production of gas wells. At the request of Conoco, the EUB ordered the shut-in of 146 gas wells. Accordingly, the NG producers wanted compensation.
    - NOTE: What we have is *deferred* production of gas. Government will pay you a sum of money, but when the gas owners produce that gas, they will have to pay an additional overriding royalty to the government. This allows the government to recoup the compensation it gave for shutting in a well.
- **The Agreement:**
    - **Para 5:** Crown must pay approx. $85 million to the owners of 146 gas wells (SPG)
        - This would be paid through royalty rebates or waivers on royalties on gas from other producing wells in the area or, if that is not enough, in the province.
            - This avoids having a politician write an unpopular cheque.
        - Amount is based on the net present value (NPV) of gas, but this is too much because the right to produce is not given up, it is only postponed.
            - Therefore, the NG companies granted the Crown a gross overriding royalty (GOR) for all natural gas and gas products obtained from that natural gas produced from the Wabiskaw-McMurray Zone from the 146 wells that were shut in temporarily
    - **Para 7:** Gross overriding royalty (GOR) is a % over the normal royalty rate. In this case it was 11%.
        - The GOR applies to any production from the shut-in wells once production from them is permitted
        - The rebates apply to wells that are currently producing and are not shut in
    - **Para 12:** Conoco's slice of the $85 million pie is $20 million, and they do not write a cheque to the government.
        - Instead, they pay a larger royalty on the Surmont leases.
        - 2026 is when Conoco gets to start paying it back or when the revenue from the Surmont project exceeds the sunk costs. This is obviously hugely beneficial to Conoco
        - NOTE: Royalties are not technically royalties. Rather, they are a net profits interest.
    - Another route is to allow for gas development but not at certain depths where the gas is associated with the bitumen resource (where the bitumen recovery will be impacted)
- **Notes**
    - **Board ordered shut-in of gas wells at Conoco's request [note: Conoco purchased Gulf in 2001]**
        - As a result of the shut-in, there was a limitation on the holders of the NG lease to produce the resource
        - Leads to a mediation
    - **Mediation results in Agreement, including the government. Authorized by Order in Council**
    - **Memorandum of Understanding (MOU) → Alberta/Conoco/Surmount Producers Group**
    - **Agreement? (Alberta payment to Surmount Producers, partial re-payment by Conoco)**
    - **Paras 2, 5, 7, 12:** Interesting use of royalties and deferred payments
        - Agreement that results
            - SPG gets compensation now
                - Largely from the government, in the form of a reduction of Crown royalties on other producing wells
            - Gulf also has to throw in $20M as part of the deferred payment
        - Does the NG holder get to keep all of this money?
            - No, when they return to production of these wells, there's going to be an increased royalty to the government

8. COALBED METHANE

Overview

- **What is Coalbed Methane?**
    - Methane that is trapped in a coalbed
    - **Composition:** CBM is similar in composition to gas-cap gas and exists in 3 states:
        - (1) Free gas within the porous material;
        - (2) Dissolved in water in the coal; (water pockets)
        - (3) Gas adsorbed on the solid surface of the coal held there by VdW forces
            - Coal pores have a larger surface area than other rock, so more gas exists in this state in coal.
- **How is it formed? (p. 86)**
    - Through process of organic matter being compressed, coal and methane are produced
- **How much Coalbed Methane is in Alberta?**
    - There is a substantial amount of coal and coalbed methane in Alberta

        - A 2006 study by the EUB says that 14 trillion cubic feet of CBM was found *in situ* in AB, with around 100 trillion cubic feet recoverable given existing technology
        - For comparison, in 2006 it was estimated the ultimate potential of marketable conventional natural gas in Alberta to be 5.7 - 7.1 trillion cubic metres
        - In 2005 AB produced 2.9 billion cubic meters of coalbed methane and over 2000 wells were drilled
    - Value of most coal in AB is not very high.
        - You need to burn a lot of coal to get the heat you need, and greenhouse gas emissions produced per unit of energy is very high
        - This much coal in AB does not have a big future because it is too intensive to use.
- **Why is it unconventional?**
    - Since it needs stimulation to flow (doesn't have a tendency to flow like a gas cap for example) – there must be depressurization of the coalbed to release the methane for extraction
    - Common practice to stimulate a well to assist CBM production through **artificial hydraulic fracturing**
    - Fracking involves pumping large volumes of fluids (commonly nitrogen) into the wellbore to create fractures that allow better contact between the well and the natural coal seam cleats
- **What regulatory scheme is applicable to its production?**
    - Regulated largely in a similar means in which natural gas is regulated, with some additions
    - CBM operations not covered by existing gas regulations are handled by special applications
    - All produced water from CBM wells in Alberta requires disposal by deep well injection.



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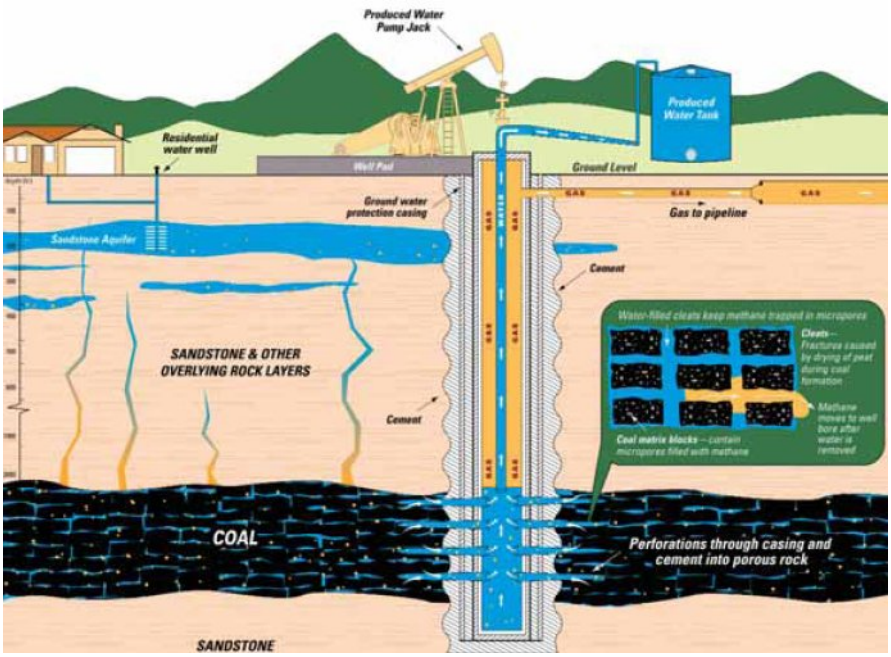
    - Have a coal seam → will have its 3 forms of methane in it
    - You have an injection well, to fracture coal, to give pathways for molecules to move through
    - Return used substances to the surface, then use wells for extraction

- 

  - When you fracture CBM or shale, and you're removing the used liquid, you have to keep those fissures open
    - So you have to inject a **proppant** which keeps the fissures open
    - A common proppant is silicon

Amoco Production Co v Southern Ute Indian Tribe **(1999, USSC) – Vernacular Test at the Time of the Grant; Coal Reservation Does Not Include CBM**

- **Facts**
  - The US government reserved coal rights in its land grants to settlors; the government later returned to the Ute Indian Tribe, in trust, previously ceded reservation lands held by the government, as well as the rights to coal under the previously ceded lands (some of which was now in the hands of settlors, pursuant to Acts in 1909 and 1910); the coal was high in coalbed methane and the dispute arose over who owned the coalbed methane, and whether the coalbed methane had been included in the reservation of coal that was excluded from land grants to settlors
- **Issue**
  - Do the owners of coal (from limited land patents under the *Coal Lands Act*) also own CBM?
- **Analysis**
  - **Test:** To determine whether CBM is part of the coal reservation, the question is: At the time of the grant/reservation (1909-1910), what was intended by the reservation of coal?
    - Court: A common understanding of coal and gas at the time was that coal meant the solid rock substance that was the US's primary energy source
    - Recall: ***Borys*** held that the meaning of the reservation in a grant was to be determined by the **vernacular test at the time of the grant**
    - Evidence used by the Court: Dictionary terms, common practices in the early 1900s (gas was treated as a nuisance associated with mining coal), idea of what the major energy source in America was at the time of the reservation (coal)
  - The difference between coal and gas in 1909 to the ordinary reasonable person:
    - (1) Coal is a hard rock, and gas is something that exists in a vaporous state.
    - (2) Methane was understood as a **distinct** substance that escaped from coal as coal was mined, rather than a part of coal itself
  - **Right to mine the coal may imply the right to release gas incident to coal mining where it is necessary and reasonable to do so.**
- **Holding**
  - CBM belongs to the surface/gas owner, not the coal owner
- **Dissent (Ginsburg J)**
  - Took the view that ownership should follow responsibility (i.e. coal owners have been involved with the coalbed methane for over 100 years and coal owners were expected to take care of the liability of the methane associated with coal) and that Congress would not likely have intended a change in ownership because a liability became an asset
  - Would have applied the canon that ambiguities in land grants are construed in favor of the sovereign

- **Ratio**
  - The meaning of a reservation in a grant is to be determined by the vernacular at the time of the grant; coal was understood to mean solid hydrocarbon and coalbed methane was understood as a distinct substance, in gas form
- **Notes**
  - **Coal & CBM chemistry: free gas; gas in water; adsorbed gas (pg. 86)**
  - **Facts**
    - Energy crisis
    - US Gov under the Coals Act issues land patents out west, but through that legislation **reserved** coal
      - In these grants, the government also granted southern territory; later they rescind these grants to Ute tribe, and also the coal
      - Contest: Whether the tribe also has ownership therefore of the CBM?
  - **Issue: do the owners of coal (from limited land patents under the *Coal Lands Act*) also own CBM?**
  - **1981 Opinion from the Solicitor of the Department of the Interior**
    - Coal is a solid HC resource, CBM is distinguishable
  - SCOTUS – fall on the same side as the Canadian court in ***Borys:*** ordinary, vernacular meaning
    - Resources
      - Coal – solid resource
      - CBM – something different
    - Important time to look at meaning: At the time of reservation/grant (here, early 1900s)
  - **Application of interpretation:**
    - Coal does not include CBM in a coal reservation:
      - Gas is not solid
      - CBM escapes from coal & is not mined
      - Meant to reserve "energy fuel" in a moment of potential crisis
      - Waste or resource?
        - Most likely considered a waste at the relevant time
      - Congress not concerned about the right to produce the CBM: how to resolve such tensions?
      - What did J. Ginsburg say in dissent?
        - Even if at material time, ownership fell to coal owners…now, we're saying they should be excluded from the benefit?

Re Bearspaw Petroleum Ltd **(2007, AEUB) – Coal Reservations Do Not Include Rights to CBM**

- **Facts**
  - Encana, as the owner of the coal rights, was arguing that the well licences for production of coalbed methane by the gas rights owner (Bearspaw) should not be granted because Encana, as the coal owner, was entitled to the CBM
- **Issue**
  - Was the mineral owner with gas or coal rights entitled to the CBM?
- **Analysis**
  - **What is the AEUB's role here?**
    - Giving on opinion to the parties (however it isn't necessarily determinative)
    - AEUB is not a court, but it is trying to quiet title in this instance
  - The board determined that according to the ***Borys*** principle, the plain meaning of coal understood in the early 1900's was a solid substance (similar to the rationale in the US in ***Southern Ute***).
    - Definitions of coal that included CBM appeared to be a more scientific understanding of the fuel, beyond that understood by normal, prudent businessmen.
    - The **vernacular meaning of coal at the time did not include the presence of CBM.**
      - Vernacular meaning through history was consistent in distinguishing coal as a solid substance separate from CBM
  - Encana argued that contractual interpretations should differ from the statutory interpretation that was done in the ***Southern Ute*** case
    - Court responded that the statutory reservation in the ***Southern Ute*** case is similar in wording to the broad terms used in the grants and reservations found in the instruments associated with the applications
    - Other Canadian literature supported that coal commonly referred to a solid combustible substance that did not include gas in its definition in the early 1900s
- **Holding**
  - Board found that the "coal" in the instruments does not include CBM, so Encana and CDP do not own or are not entitled to the CBM; the issuance of well licences for CBM separate from the coal reservations was therefore justified
- **Ratio**
  - Coal reservations do not include rights to CBM
- **Notes**

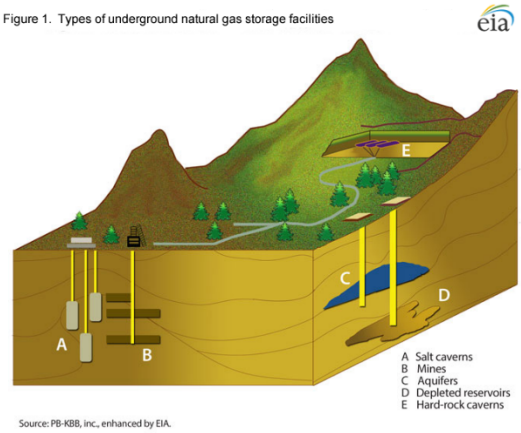
- **Facts**
  - Similar dispute as last case
  - Note: Decision heard by the **predecessor** of the **AER** (not a court)
- **Issue: who owns the CBM?**
- **What use does the Regulator make of existing precedent—source & style?**
  - Looked at ***Borys*** and ***Southern Ute*** decision
- **Vernacular meaning of coal excludes CBM, historically and presently**
  - Also endorse the courts from these cases
  - Ability to mine CBM falls to the NG holder

Legislated Clarification?

- **Coalbed methane (*Mines and Minerals (CBM) Amendment Act*)**
  - **10.1**
    - (1) **Coalbed methane is hereby declared to be and at all times to have been natural gas.**
    - (2) Subsection (1) does not affect any conveyance, agreement, agreement for sale, lease, joint venture or any other contract that specifically grants, leases, excludes, excepts or reserves rights in land in respect of coalbed methane and that was entered into before the coming into force of this section by
      - (a) The owner of the title to natural gas in the land, or any person holding natural gas rights through that owner, and
      - (b) The owner of the title to coal in the land, or any person holding coal rights through that owner.
    - (3) The owner of the title to natural gas in any land, and any person holding natural gas rights through that owner, **has no right of action and shall not commence or maintain** proceedings against the Crown, the owner of the title to the surface of the land or the coal in the land, or any person holding coal rights through the owner of the title to the coal for **damages or compensation because of extraction, production or removal of coalbed methane from the land if that extraction, production or removal occurred before the coming into force of this section.**
      - Codification of the common law rule that the owner of the coal can extract the coal by ordinary, reasonable means, and will not be held liable for the damages to the associated coalbed methane that may arise in the process
    - **(4)** It is deemed for all purposes, including for the purposes of the *Expropriation Act*, that **no expropriation occurs as a result of the enactment of this section.**
    - (5) No person has a right of action and no person shall commence or maintain proceedings
      - (a) to claim damages or compensation of any kind, including, without limitation, damages or compensation for injurious affection, from the Crown
  - **67**
    - Makes it clear that the lessee of coal owned by the Crown has no rights to any natural gas, including coalbed methane.
- **Notes**
  - The government decided to issue legislation to quiet title as it relates to CBM, because it was a valuable resource whose ownership was in contention
  - ***Mines and Minerals (CBM) Amendment Act, 2010* – p. 92**
    - CBM would be owned by natural gas holder except where there was a transaction previously to transfer CBM rights between the natural gas holder and the coal owner (10.1(2))
    - Express statement that there will no action for expropriation from this legislative action
    - Applied both to freehold leases and crown leases
    - Retroactive legislation that deters future litigation
  - So: **Natural gas owner gets CBM (*unless* previously disposed of; no actionable wrong for prior interference with CBM)**
  - **Encana Corp. had initiated a court action to determine ownership of CBM *prior* to legislative amendments; court determined that the amendments + s. 67 were determinative**

9. STORED GAS

Overview



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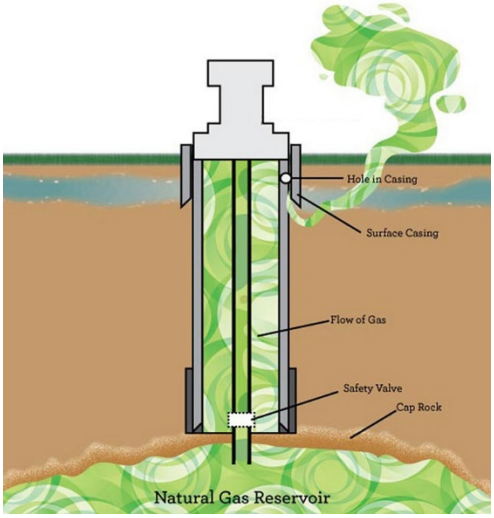
  - You can store gas
  - Different things to look for
    - Salt caverns
      - Have interlocking crystalline feature that's highly porous
      - E.g. Strathcona Salt Cavern Storage project in Edmonton
    - Depleted mine
      - Mine space where mineral was removed
    - Aquifers
      - Subterranean water
    - Depleted reservoir
      - E.g. You had an oil/gas reservoir that is fully depleted
    - Hard-rock caverns
      - Usually close to the surface

Aliso Canyon (California) NG Storage Field

- 

  - Example of storage that didn't work
  - Prolonged multi-year release
  - Failure in casing near surface; led to highly pressurized methane being released

        - Potent GHG release
- Why would a NG distributor have this kind of thing at their disposal?
    - You can know how much is available to you
    - Consumer demand
        - E.g. Buy when it's a low price, store it, and then sell it for a higher price in the winter

Hammonds v Central Kentucky Natural Gas Co **(1934 KY Ct App) – Not Liable in Trespass for Injecting Gas Under Someone's Land; Gas Ceased to Be Injector's Property; Oklahoma Wild Animal Theory**

- **Facts**
    - Central Kentucky (respondent) injected gas into previously drilled wells into an underground reservoir
    - The appellant held surface rights above the reservoir and she brought a suit to recover a large sum for use and occupation under the idea of trespass, it being charged that the gas was placed in or under her property without her knowledge or consent
- **Issue**
    - Is Central Kentucky liable in trespass for using the appellant's property?
- **Analysis**
    - Oil and gas are not the property of any one until reduced to actual possession by extraction, although by virtue of his proprietorship the owner of the surface, or his grantee of the severed mineral estate, has the exclusive right of seeking to acquire and of appropriating the oil and gas directly beneath.
    - Endorsement of the wild animal ownership theory:
        - Theory: Oil and gas are similar to wild animals in that absolute ownership is not attained until they are reduced to possession; if wild animals are released from capture, they cease to be property of the capturer
    - So, when gas is put back under pressure into the natural reservoirs it assumes again its original character and becomes part of the land to which it is attached
        - Therefore, the gas, once released, ceases to be under the exclusive ownership of the company, and the surface rights holder cannot hold the company liable for using their property to store their gas
        - It also means that the surface owner could also drill a well and extract the stored gas, so there was an incentive for the oil and gas company to pay the landowner not to ink a well and extract the gas
- **Holding**
    - Central Kentucky not liable for trespass; the gas ceased to be under their exclusive ownership when it was injected into the ground
- **Ratio**
    - In Kentucky, a company ceases to own gas when it returns it to the ground
- **Notes**
    - **Facts**
        - O/G operator has effectively depleted a massive reservoir
        - Mrs. H lives on a small parcel of land in the middle of the reservoir
        - Gas company (Kentucky) has started using the depleted reservoir as a storage site; Mrs. H upset
            - Her argument: You're trespassing on my subterranean land by injecting a gas which is then migrating under my property (*remember that gas has a tendency to migrate*)
                - Suing in trespass
    - **Issue: nature of ownership in natural gas once it is pumped back into a depleted reservoir**
    - **What theory of ownership does the court endorse? And what is the consequence for ownership of injection?**
        - Follows the Oklahoma approach for a resource after it has been ejected – wild animals
            - When they had the gas at the surface, it was under their possession, and they owned it
            - Then, when released underground, it's "back to the wild" and ownership is lost
            - *Essentially, they're comparing it a released animal*
        - Consequence of injection – you **lose** your possessory right; open for someone else to capture now
    - **Does Hammonds still get what she wants?**
        - Loses on trespass claim, since the gas that's percolating under her is not the ownership of Kentucky anymore
        - But can she still get compensation?
            - Even though she loses at court, she's going to enter into an agreement for compensation which gives the gas company the right to use the storage space

Lone Star Oil & Gas v Murchison **(1962 Tex Ct Civ App) – Stored Gas Continues to Belong to the Gas Owner Who Extracts it; Opposite of *Hammonds***

- **Facts**

- Lone Star (the appellant) injected "extraneous gas" (gas which has been produced elsewhere, acquired and owned and then, for purposes of storage, injected) into the Bacon storage reservoir underlying about 4,000 acres in Henderson County
- The appellee sought or began to use the gas that was injected into the reservoir
- Lonestar then sought damages and redress from the conversion of gas which they contend is its personal property

- **Issue**
  - Did the title and ownership of the extraneous gas, which the appellant acquired and stored in the underground reservoir for use, pass from appellant to appellees?
- **Analysis**
  - The Court did not apply ***Hammonds***, saying that the wild animal or water analogies do not translate to oil and gas
  - There can be no doubt that gas which has been produced is personal property, and does not cease to be property when stored underground, unless it is abandoned
  - The owner of personal property does not lose his title thereto by not having the property on his person or on his land unless there is abandonment, and abandonment requires an intent to abandon, which is not present in this case
  - Implied in the outcome: Since the gas owner is still the owner of the gas, there could be a successful action in trespass by the surface owner against the gas owner
    - So either way, the surface owner is going to receive compensation (either for trespass or to ensure that they do not begin to extract the gas)
- **Holding**
  - In favour of Lone Star; the owner of gas does not lose title thereof by storing the same in a well-defined underground reservoir.
- **Ratio**
  - Stored gas (extraneous gas), once injected into an underground reservoir, continues to be exclusively owned by the party that extracted it and reduced it to possession in the first place, unless it is abandoned
- **Notes**
  - **"Extraneous Gas" defined**
    - Gas that has been produced elsewhere, and is being injected somewhere else for the purpose of storage
  - Court doesn't endorse Oklahoma theory, and uses another one: Absolute ownership with some limitation
  - **Distinguishing *Hammonds***
    - First noted that it was already distinguished in a previous case
  - **Dismissing the wild animal and percolating water analogies**, why?
  - **Gas that has been produced becomes personal property; title not lost unless abandoned (which requires intention)**
    - When injected, you're not losing title since there's **no abandonment**
    - Opposite result of ***Hammond***, which in turns means…
  - **Can, however, constitute a trespass**
    - What this means: P will likely have to be compensated
    - What companies will need to secure are storage rights in order to use them

Mines and Minerals Act on Storage

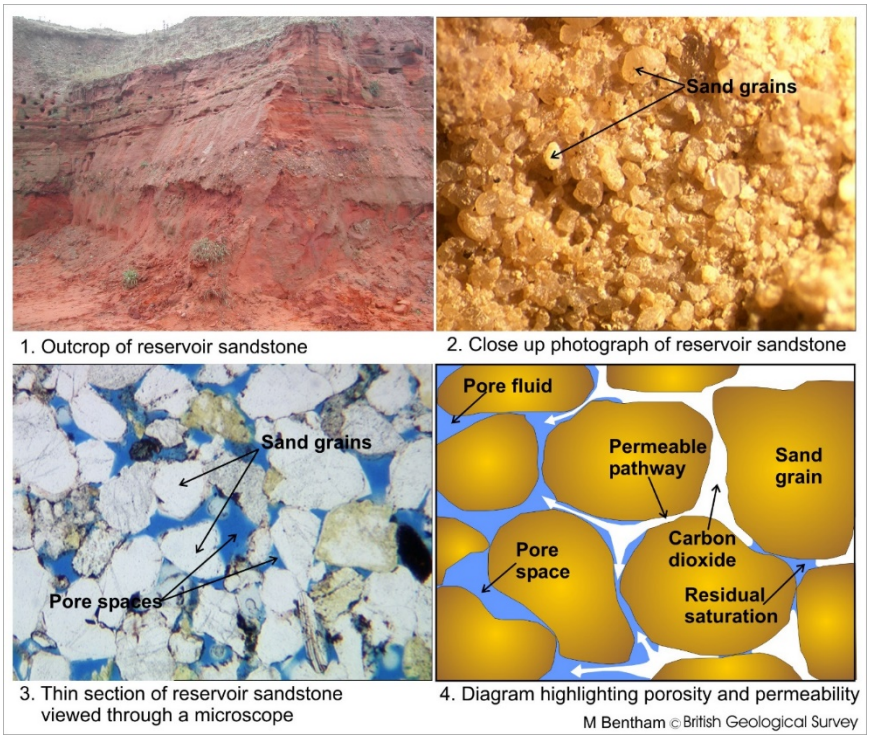
- **Injection wells**
  - 56(1) Subject to section 57, a person has, as against the Crown in right of Alberta,
    - (a) the right to use a well or drill a well for the injection of any substance into an underground formation, if the person is required by or has the **approval of the Energy Resources Conservation Board to do so**…
  - (2) A person who exercises a right referred to in subsection (1)(a)
    - (a) **shall indemnify the Crown in right of Alberta for loss or damage suffered** by the Crown in **respect of any claims or demands** made by reason of anything done by that person or any other person on that person's behalf in the exercise or purported exercise of that right
- **Ownership of storage rights, etc.**
  - 57(1) Subject to subsection (2),
    - (a) where a person owns the title to petroleum and natural gas in any land, that person is the **owner of the storage rights with respect to every underground formation** within that land, and
      - So where there is no split title, the owner receives the storage rights on that land
    - (b) where one person owns the title to petroleum in any land and another person owns the title to natural gas in the same land, those persons are **co-owners of the storage rights** with respect to every underground formation within that land.
      - Split = Co-owned
  - (2) Where a person owns the title to a mineral in any land and operations for the recovery of the mineral result or have resulted in the creation of a subsurface cavern in that land, that **person is the owner of the storage rights with respect to that subsurface cavern to the extent that it lies within that land**.
    - If you own a certain mineral title and it's mined creating a cavern, that mineral holder gets that cavern storage space

- (3) A person who has storage rights in respect of a subsurface cavern within any land **has the right to recover any fluid mineral substance stored in that cavern**, to the exclusion of any other person having the right to recover a mineral from the same land.
  - If you inject anything, you have the exclusive right to recover it
  - So you if you have a valid storage right, you can exclude others from removing fluid from that storage cavern

- **Notes**
  - Who owns subterranean caves?
    - The surface owner
    - This legislation doesn't expressly say this, so the surface owner would get a natural cave
    - To overrule this, you would need express statutory language
  - What constitutes a mineral?
    - In some jurisdictions, limestone is a mineral, and in others is not, for example
      - If it isn't, and you work to make a cave, you don't have to worry about it falling to the mineral holder (since it's not a mineral)
      - If it is a mineral, then the storage falls to the mineral right's holder

10. Carbon Capture and Storage

What is Pore Space?



1. Outcrop of reservoir sandstone
2. Close up photograph of reservoir sandstone
3. Thin section of reservoir sandstone viewed through a microscope
4. Diagram highlighting porosity and permeability

-
- Could be sandstone (rock that can crumble/break apart)
  - There are **pore spaces** between the sand grains, even in the large clumps
    - Essentially interstitial space
  - Between the pore spaces, are **permeable pathways**
    - These can be filled

CCS Issues

- 1. Climate Change
  - Instead of saying we're going to eliminate the processes to achieve reductions in CO2, CCS would say "we can capture the CO2 and store it safely"
  - In order to make it work, the government has to be able to find storage space that is suitable for the LT
- 2. *Carbon Capture and Storage Statutes Amendment Act, 2010* + its problems

- Amendment to the MMA through the CCSSAA
- **15.1**
  - **(1)** It is hereby declared that
    - (a) **no grant from the Crown of any land in Alberta**, or mines or minerals in any land in Alberta, has operated or **will operate as a conveyance of the title to the pore space** contained in, occupied by or formerly occupied by minerals or water below the surface of that land,
    - (b) the pore space below the surface of all land in Alberta is vested in and is the property of the Crown in right of Alberta and remains the property of the Crown in right of Alberta
    - Notes
      - Crown owns the pore space, it's retroactive (has been and always will be)
      - This almost sounds like expropriation/taking by the Crown…
      - Pore space is also somewhat undefined
  - **(3)** The Minister may enter into agreements with respect to the use of pore space.
  - **(4)** It is deemed for all purposes, including for the purposes of the Expropriation Act, that **no expropriation occurs as a result of the enactment** of this section.
    - It is ruling by statute that this isn't expropriation
  - **(5) No person has a right of action and no person shall commence or maintain proceedings**
    - (a) to claim damages or compensation of any kind, including, without limitation, damages or compensation for injurious affection, from the Crown, or
    - (b) to obtain a declaration that the damages or compensation referred to in clause (a) is payable by the Crown, as a result of the enactment of this section.
- Amendments also state that:
  - Province would accept long term liability for issues that may arise
  - Creates stewardship fund for maintenance of CCS structures in the long term
  - Deals with corporations that go bankrupt – government will take over management

- 3. Post-amendment conflicts
  - May be conflicts in the future e.g. oil and gas company wanting to develop a resource in close vicinity to pore space, where the extraction would disturb the pore space
  - The provision creates some uncertainty in what pore space is and it creates a clash with private ownership rights

11. Interests Under the Lease

The Conundrum

- **"The typical energy company has expertise and access to capital, but cannot afford to maintain a land inventory for exploration if the land is bought outright at a price determined by what 'might' be under it. The other side of the coin is that owners of subsurface oil and gas are naturally reluctant to sell outright for substantially less than the value of the hydrocarbons which might be under the land…"** – Freehold Owners Association
  - Why do we even have leases in the first place, and not outright ownership?
    - It's too expensive to go around purchasing mineral titles (e.g. it would be $10M vs $100K with a royalty payment)
    - There's a bit of speculation too with how much you can get out of the land
    - As well, the surface owners (who lack the expertise and capital) are reluctant to deal with the property in a way that could result in less than the full benefit – they have the legal rights, but no expertise
    - The lease allows to account for each parties' interests

The Lease Response

- **Typically, the lease "provides for an energy company (the lessee) to pay an owner (the lessor) a sum of money (the bonus consideration) for the exclusive right, but not the obligation, to conduct exploration and/or development on the owner-lessor's lands for an agreed period of time (the primary term) and to produce the any leased substances which may be found to exist beneath the lands until these substances are depleted…"**
  - Most of these periods of time last 5-10 years
  - If they find something, the lease allows you to maintain production until depletion (second term); landowner also gets a royalty
- **Further, the "right to produce is invariably coupled with an obligation to pay the owner an agreed share of any leased substances produced and marketed from the lands (the royalty). The owner-lessor also usually receives rent on an annual basis during the primary term before production is established (the delay rental)."**
  - Owner could get screwed on this though
    - You may not be getting much from the delay rental while the lessee is still producing
- **There are 2 forms of leases**

- **1. Crown leases**
  - **Form set by Alberta Energy (or its equivalent). Directs primary terms and royalty rates. Only the bonus consideration is negotiable. For the benefit of public ownership.**
    - Governments hold the power; not much is negotiable; most rules are set by Regulations
- **2. Freehold leases**
  - **Corporate ownership directs its form and lease terms dictated by the lessee and not the resource owner. Often, developments and changes to the standard form will benefit the resource owner.**
  - **As stated by Professor Merrill (US): "The lessee comes armed with a printed form, the product of legal and business experience."**
    - A lot more open-ended
  - **Interpreted as if the parties had equal negotiating power the lease.**
  - **'Producer 88' "unless" form: lease terminates on its own *unless* a well is drilled by a certain date *or* a delay rental payment is made.**
    - The Freehold Owners Association tries to even the playing field with the first kind of standard form: Lease terminates unless the well was drilled by a particular time
  - **Canadian Association of Petroleum Landsmen (CAPL) + Natural Resources section of the CBA produced the CAPL lease. Now known as CAPL 99**
    - The standard form pretty much used today

Berkheiser v Berkheiser **(1957 SCC) – Petroleum and Natural Gas Lease is a Profit a Prendre; Revisionary Interest (Remaining Oil and Gas) Belongs to the Bequest of the Will; No Severance in Title from a Profit a Prendre**

- **Facts**
  - In the last few years of the testators' life, she did a few things. In 1947, she left a quarter section of land in her will to the appellant. In 1951, she leased the petroleum and natural gas in the same quarter section to an incorporated company for a term of 10 years "and so long thereafter as the leased substances or any of them are produced"; She died in 1953.
  - The lease was terminated in 1955
  - The appellant claims that he is entitled to interest in the petroleum and natural gas (including the $160 acreage rental payment), while the respondent claims it should go to the residual beneficiaries (they themselves are a residual beneficiary)
- **Issue**
  - Who owns the mines and minerals that were leased?
  - To whom does the acreage rental payment belong?
- **Analysis**
  - Why an oil and gas lease is more like a profit a prendre than a normal lease
    - The resource in question is used and the property is substantially different after the term of the lease
    - More like a profit a prendre or an irrevocable license to work and win
  - Although called a "lease," a PNG lease is actually more like a profit a prendre: an incorporeal right to explore and work the land for the petroleum and natural gas
    - It does not fit into any category perfectly, but is analogous to a profit a prendre (ie. an interest in the land) like the right to hunt for fish or fowl on someone's land.
      - When a profit a prendre expires the land goes back to the owner minus what has been taken out, which may be nothing, or a portion
    - This was 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;
      - So there is a right of reverter at the end of the lease (interest is determinable)
      - It follows that both the right to the payment of $160 and the reversionary interest in the petroleum and gas ensured to the appellant (lessor)
  - The argument of the respondent was that reality it was that the lease had severed the mineral rights from the rest of the testator's estate (even though everything was already devised in a previously written will)
    - This type of severance from a will is known as **ademption**
      - Principle from Wills that when you leave something in a will that does not exist or to which there is a priority interest (e.g. it was sold after the creation of the will), then this automatically retracts the devise of the property in the will
      - However, the **creation of the profit a prendre does not bring about a separation of the estate, which would be the necessary basis for the operation of the doctrine of ademption**
- **Holding**
  - Appeal allowed; The fruits of the NG lease belong to the appellant surface rights holder (to whom mineral rights were bequested in the will)
- **Ratio**
  - In Canada, an oil and gas lease is a profit a prendre - an interest in land but NOT a transfer of title

        - Proprietary interest becomes real only when a substance is under control
- **Notes**
    - **Facts**
        - Situation where family suing family because of a will gone bad
        - In 1947, a will was established for an elder B, which gave the appellant in the will a quarter-section of land
        - Then, in 1951, they entered into a lease agreement for the land in question, which has a 10 year primary term, and will exist so long as production continues
        - They die in 1953
        - From 1954-1955, the lease is terminated
        - Contest comes down to the appellant who was the beneficiary vs the residuary beneficiary under the well
            - Argument from appellant: This was gifted to me
            - Argument made by residual: the substance of the gift no longer exists; as such, the mineral aspect subject to the lease cannot go to the person with the quarter-section; rather, it should fall to the residual beneficiary
    - **Trial decision**
        - Here we have a sale of a corporeal hereditament – sale of a tangible thing
        - The lease was a sale of the minerals (***this is wrong…***)
    - **Reasoning**
        - **An O/G lease does not sever title or ultimate ownership**
        - The lease instrument gives the lessee a **profit a prendre** (an interest more akin to a "right of way")
            - ***This case confirms the status of an oil and gas lease, use this case to prove that point***
        - **A profit a prendre doesn't result in a severance of title; it's something short of it**

IFP Technologies v EnCana Midstream and Marketing **(2017 ABCA) – Farmhouse Agreement; Contract Interpretation Approach; Working Interest**

- **Facts**
    - IFP (farmee) and PCR (farmor) entered into an agreement to use SAGD (IFP's tech) to enhance oil recovery at one of PCR's exhausted properties. In exchange for the right to use the technology, PCR agreed to give IFP "a 20% working interest in all development at Eyehill Creek"
    - As part of their contract, PCR and IFP agreed to give the other a right of first refusal if one of them wanted to sell their respective working interest to a third party.
    - PCR allowed their Crown Lease to lapse and only bid $1800 to reacquire it. Wiser Oil paid $1M
    - Wiser was planning on beginning primary production on certain sections which IFP was also interested in testing SAGD on – it was impractical to do both.
    - On behalf of Wiser, PCR sent IFP a letter asking them to acknowledge that they owned "no more than a 20% interest in petroleum substances produced by means of thermal or enhanced recovery" and that it had no right to receive information from Wiser.
        - What Wiser wants IFP to agree to here is a lesser interest than what was agreed to (all development was in the original agreement)
    - When PCR gave IFP the ROFR, IFP refused to consent to PCR's disposition to Wiser. Despite this, PCR entered into an agreement with Wiser anyways, agreeing to indemnify Wiser from any liability of Wiser to IFP.
    - Wiser began extracting petroleum and natural gas using primary production methods.
    - IFP sought damages for breach of contract and lost opportunity, or an accounting for 20% in the alternative.
    - The trial judge determined that IFP's working interest was limited to oil and gas produced *only* from thermal and other enhanced recovery methods at Eyehill Creek.
- **Issue**
    - Did IFP's "20% working interest" extend to primary production and enhanced oil and gas leases, or limited to enhanced recovery only?

- **Analysis**
    - The trial judge failed to take into consideration the factual matrix surrounding the contract
    - **Working interest** = the percentage of ownership that an owner has to explore, drill, and produce minerals from the lands in question
- **Holding**
    - IFP's working interest is in **all development** at Eyehill Creek
        - TJ did not look at the negotiating interest
        - Interest held by IFP extended to primary production
- **Notes**
    - Facts
        - **Asset Exchange Agreement re: leases in the Eyehill Creek area**
        - **Born out of a "Farmout Agreement" relationship ("Farmor" lease holder and "Farmee" service provider)**

        - **PCR sold its interests to a third party, who sought to re-activate suspended wells and engage in primary production. IFP did not consent; ROFR engaged**
    - Important concepts
        - **Farmout – p. 103**
            - Often, an o/g company (primary lessee) will enter into an agreement, but won't have all the expertise that's needed (e.g. they may need a company that knows seismic testing really well)
            - It might be beneficial to enter into a farmout agreement: Transfer part of the lessee's interest to another company; will be framed as a Gross Overriding Royalty
                - E.g. We need help with horizontal drilling; we'll give you 3% GOR out of production if you can help us
                    - The horizontal drilling may make a lot of money from this, so they can be beneficial
        - **Contract interpretation approach – pp. 106-107**
            - Can you look to the factual scenario/matrix surrounding it → Yes
        - **"Working Interest" – p. 108**
            - It is true that the AEA does not expressly define the term "working interest". But that is unnecessary, indeed irrelevant, in the circumstances here since "working interest" is a legal term of art. On this point, the law is clear that a "working interest" in relation to mineral substances in situ is a particular kind of property right or interest in land. When the owner of minerals in situ (the Crown in this case) leases the right to extract these minerals (here to PCR), the right to extract is known as a "working interest". Therefore, simply stated, "working interest" constitutes the percentage of ownership that an owner has to explore, drill and produce minerals from the lands in question….
                - This working interest is registerable, and can be transferred – like the 20% that was transferred here for IFP

12. Subsurface Disturbances

(a) Blow-Outs

Overview

- **What is a blow-out?**
    - The uncontrolled flow of gas, oil or other fluids from a well which occurs when the pressure within the well exceeds the pressure in the borehole applied to it by the column of drilling fluid. Also results in the release of toxic sour gas
- **How common are they?**
    - Less common than they used to be; pressure control technology is much better
    - However, they happen every couple years in AB
- **State of the law?**
    - We don't have clear or express language on how law will operate in this scenario in Canada; so, you can look to the USA potentially
    - Usually results in regulatory intervention – the Government intervenes

Elliff v Texon Drilling Co (1948 Tex Sup Ct) – Negligent Waste of Oil and Gas from Shared Reservoir; Rule of Capture Does Not Apply to Blow-Outs

- **Facts**
    - Petitioners Elliff owned surface and royalty interests in land subject to oil and gas leases
        - Failure on one of well sites on D's (TDC's) land led to that well blowing out, cratering (surface collapse), which expanded and subsumed P's well which blew out and cratered too;
        - Dissipated large quantities from the reservoir
        - Cause of action?
            - Nuisance? Unreasonable interference with use and enjoyment of land
            - Interference with right to support? Trespass?
            - Negligence? Texon not maintaining well properly, with direct damages resulting
                - Ended up claiming negligence, with damages including death of animals
                - Also wanted to be compensated for every barrel of substance they otherwise would've been able to produce from that land

- P's argument: TDC caused the blowout through their negligence, which wasted the oil and gas that they (P) would have otherwise recovered. They also had a royalty interest in the land, and now they would not receive the royalty rate on the oil and gas that was wasted
- D's argument: Rule of capture - they claimed they were both entitled to take from the pool, but that the D had done so more rapidly. They shouldn't be liable because the plaintiffs did not obtain ownership of the oil and gas until they reduced it to possession.
- The trial court rendered judgment for the plaintiffs for $154,518.19, which included $148,548.19 for the gas and distillate, and $5,970 for damages to the land and cattle
- The Court of Civil Appeals reversed the judgment and remanded the cause (in favour of the Defendants). Their decision rests upon 2 grounds
  - Petitioners could not recover because under the law of capture they had lost all property rights in the gas or distillate which had migrated from their lands.
  - Recovery cannot stand because the trial court had submitted the wrong measure of damages in that petitioners' claim "is for trespass in and to a freehold estate in land and the proper measure of damage is the reasonable cash market value before and after the occurrence complained of."

- **Issue**
  - Does the law of capture absolve TDC from liability for its negligent destruction of the plaintiff's OG, recognizing that substantially all of the wastage occurred through the opening on TDC's leased land?
- **Analysis**
  - Texas is an absolute ownership state where a landowner is regarded as having absolute title to the oil and gas beneath his land (*in situ* ownership) subject only to the law of capture. **Capture means reasonable capture and does not include a blowout.**
    - There is absolute title to oil and gas in Texas, but a neighbor may appropriate the oil and gas that have flowed from adjacent lands without the consent of the owner of those lands, and without incurring liability to him for drainage
    - **BUT**:
      - No owner should be permitted to carry on his operations in reckless or lawless irresponsibility, but must submit to such limitations as are necessary to enable each to get his own
      - In this situation, the way that the defendants were working the resource was not reasonable
  - There are only two limitations on OG ownership in Texas:
    - Each owner is to be afforded:
      - (a) A reasonable opportunity to produce his proportionate part of the oil and gas from the entire pool and
      - (b) Has a duty to prevent operating practices injurious to the common reservoir.
  - **What is the P's remedy?**
    - (1) Trespass— Argues damage to the land. If trespass is the action, then damages is measured by the difference in market value to the land before and after the trespass.
      - But usually, you need to have direct physical interference with property, which was not technically present here
    - (2) Conversion— Wrongfully gaining and using for a non-permitted purpose, another's property
      - *BUT: Petrocan v Xerex* says you have to have sufficient ownership of oil and gas to support an action for conversion.
      - You own oil and gas in a sense, but don't really own it until you bring it to the surface, only when it is brought to the surface can you support an action for conversion.
    - The Court did not specifically say which theory determined the damages
    - *In Alberta, **trespass** would usually be the action that would provide the remedy, and it would be measured by the extent that the market value of the land was decreased*
- **Holding**
  - For the plaintiffs; the defendants were liable for losses; the law of capture does not absolve a party from negligent destruction of neighboring land or loss from a common pool of oil and gas
  - Respondents were legally bound to use due care to avoid the negligent waste or destruction of the minerals in common reservoir
- **Ratio**
  - While there is a certain amount of reasonable/necessary waste incident to the production of oil and gas, immunity from liability does not extend to the negligent waste or destruction of oil and gas
- **Notes**
  - Variety of concerns from blow-outs
    - The blow-out, but also surface layers can de-stabilize and the reservoir can collapse, transferring to the surface creating a crater
  - Facts
    - Blowout goes on for years; part of the process is cratering
    - The cratering starts to subsume a well on a neighboring site, which then causes a blow out there
    - End up with litigation occurring where neighbors sue the company in negligence for the situation that occurred
    - What are the biggest damages?

        - You've lost maybe of hundreds of thousands of dollars in royalties
    - Ownership scenario in Texas: Absolute ownership, with defeasible fee
        - These people would have no right to seek compensation if their neighbour drilled multiple wells to get as much substance as they could
    - Trial – liability
        - Find negligence
    - Appeal – no liability
        - This is subject to the rule of capture
    - Final Appeal Court
        - There are reasonable limits on absolute ownership and defeasible fee
        - Limits take 2 forms
            - 1) You are subject to reasonable capture from your neighbour, but that is reasonable
                - Something like a negligent blow out is **not** reasonable; it is unreasonable and won't be covered by the rule of capture
            - 2) The operations are going to be subject to limitations from state regulators
                - This is to prevent reckless irresponsibility
    - What if a blowout happened in AB, can you transpose this American reasoning, and what action could you sustain?
        - If you had a cratering event on your land, you could probably claim nuisance
        - Potentially trespass, if substances being spewed deposit on land
        - Conversion is unlikely – fluctuating price of oil and gas; you can't convert something that is in situ
        - Negligence would likely be your best bet

Atlantic Claims Act, 1949, the Regulator's Role, and the Settlement Process – Uniquely Alberta Approach for Dealing with Blow-Outs

- AB had a monstrous blowout from a well in 1948
    - Atlantic Oil Co. was described as a non-descript semi-bankrupt oil company known for cutting corners on safety
    - When the blowout occurred, oil gushed for six months and then burned for six months
    - No litigation, but the Regulator used statutory authority to take over the well, set up a trust fund that could be utilized to compensate individuals and pay for clean-up costs
- Petroleum and Natural Gas Conservation Board (now AER) entered upon the well and seized and took possession for the purpose of bringing it under control and conserving the flow of petroleum and natural gas
    - In AB, we're **more likely to see a regulator intervene (as opposed to litigation), and punish the wrongdoer and compensate those individuals that have been wronged**
- Legislature enacted *the Atlantic Claims Act* – and created a trust fund from the proceeds of the petroleum recovered from the blown out well
- **The trust fund was used to pay out claims for lost royalties, debts or damages**
    - Liability was difficult and complicated to show and it was in the public interest to dispense with the claims expediently and in an efficient fashion
- **How were persons compensated and how was the company punished?**
    - s. 3(1) – Board can pay out money over two years for any settlements that arise
    - s. 3(2) – Board authorized to pay money out of the trust fund for any of the following purposes:
        - Examples: Clean-up costs, conservation and investigative measures, and settlements
        - Note sub (c) – you can have adjacent developers arguing that they have a right for damage done to their property
    - s. 4 – Punishment aspect: Deemed the Atlantic well to have overproduced by 565K barrels.
        - To make up for this, ERCB placed restrictions on production and drilling
        - Slowed Atlantic's production from other wells to an amount not to exceed 2/3 normal production, and prevented Atlantic from drilling other wells on its property until such time that other landowners have been compensated
            - This attempted to redress the balance by allowing others to take a greater share from the common reservoirs.

Lodgepole Amoco Sour Gas Blow-Out, 1982

- There are other blowouts that are more dangerous to human life, like sour gas blow-outs
    - Blew out for 68 days; multimillion-dollar damage

Interim Guidelines for Resident Compensation, 1989 – Guidelines on Process for Compensation When You Have Something Like a Sour Gas Blow-Out Near Your Property

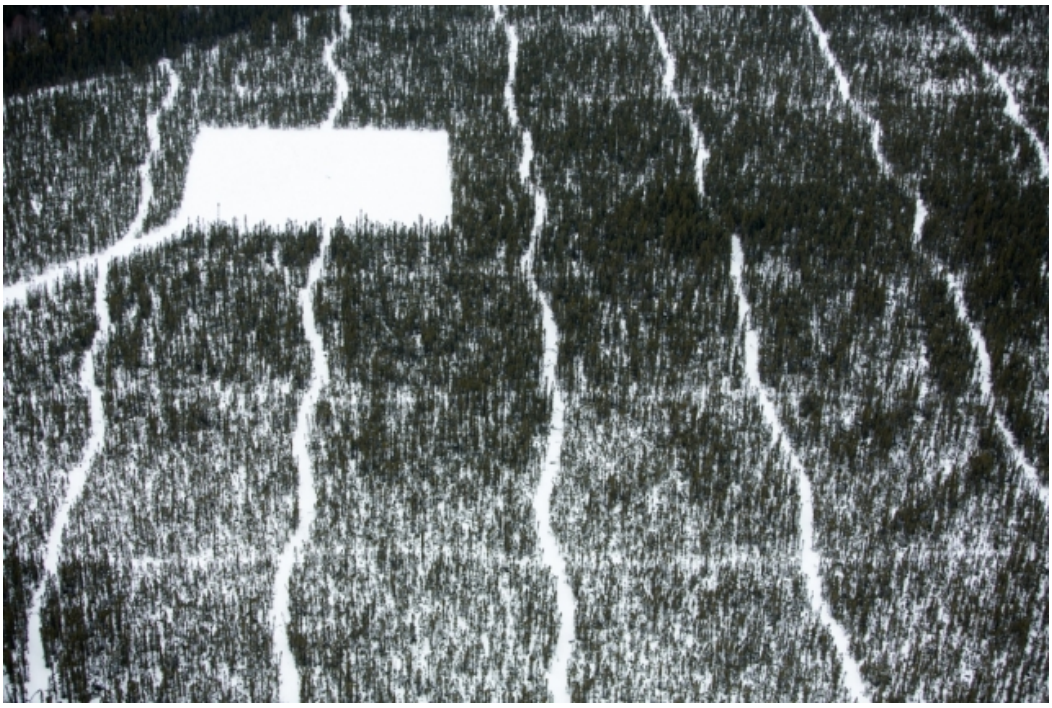
- **Drafted with the participation of industry**
- **Goal: fair & prompt compensation for those who are directly affected by a blow-out**
- **Three-tiered compensatory approach described**
    - 1) Immediate out of pocket expenses; justifiable evacuation costs
        - Hotels, meals, etc.
    - 2) Costs directly related to the release of sour gas and that emerge shortly after the blowout
        - Death of livestock, damage to buildings, etc.
    - 3) Those costs associated with longer term impacts where cause and effect are unclear, and which may require considerable investigation and documentation to verify
- **Dispute resolution process for damages within the tiers** (s. 6)
    - Negotiation (between claimant and operator first and foremost) → Mediation (decision not binding) → Arbitration (independent third party; decision binding) → Litigation (😉, expensive, time-consuming, unpredictable)
    - Self-serving document that discourages litigation/lawyers
        - This is because at that point, result can't be controlled

ERCB Investigation Report – Well Blow-Out

- Actual report that gives summary of what a blow-out looks like, and the investigation that takes place

(b) Geophysical Exploration

Overview

- 
    - Picture of well pad and access road, and seismic lines cut through forest to do exploration in terms of where you should drill
        - Seismic testing will tell you about subterranean features, and what the reservoir looks like underground
        - This will tell you where to drill
    - This has since been replaced with low impact seismic exploration – better for the environment
- Seismic exploration uses energy pulse transmitted into ground with mechanical device (vibrator truck or explosive energy)
    - When different rock formations are encountered, energy is reflected back to surface
    - Waves bounce back at different rates/angles based on subsurface features

- Geophysicists interpret recorded signals to show existence of oil and gas deposits
- Many historic exploration lines remain visible on landscape and can impact wildlife
- **Traditional approach** = seismic pot-shots
    - Create seismic lines, send out trucks which dig holes and ignite dynamite, register vibrations coming back; computer model provides picture of subsurface
        - Can't just do it in one location; need to amalgamate data
            - That's why so many crisscrossing lines
        - High-impact seismic testing means significant land clearing
    - Environmental consequences: negative human interaction, but main issue is you're altering habitat – boreal woodland caribou populations are declining
- **Low impact seismic** = using smaller equipment, create narrow path on which geophones can be placed to pick up seismic vibrations
    - Two-meter paths (instead of eight-meter) going in curvy formation that don't create wide highways used by predators
    - Allows for smaller footprint and impact, especially with heli-portable operations
    - Today, this is the standard
- Issue: **Does seismic exploration amount to a trespass?** (direct, physical invasion)
    - And how will you deal with consent?

Phillips Petroleum Co v Elliot F Cowden **(1957 US 5th Cir) – Consent from Mineral Owner was Required to Conduct Geophysical Exploration; Liable for Trespass**

- **Facts**
    - An oil company entered onto land to conduct geophysical exploration. They received permission from the surface owner to do so, but the surface owner did not own the mineral rights beneath his land. The M&M owner (Cowden) did not provide permission, and he claimed trespass.
    - Trial Court: awarded $53,640 in damages for trespass to the mineral estates of the respondents
- **Issue**
    - Who can gran the right to explore the mineral estate?
- **Analysis**
    - **Mineral rights are in the first instance almost always purchased as speculations** and are often resold as such a number of times, so it would be a peculiar rule that would permit the owner of an entirely different estate, the surface, to reduce or to sell the right to reduce to a certainty, and thereby change the whole basis of the valuation of information about property belonging to another
        - Geophysical exploration gives certainty – it gives value to the estate
    - Defense: That the appellants were merely seeking information for the minerals under the adjacent land, which they owned
    - The Court said there was an action in trespass; not in conversion for the information that was gained
    - **Was there a trespass?**
        - Trespass is a direct interference with someone else's property. It is an action that does not require any damage.
            - The court called this a geophysical trespass, on the basis that the shockwaves shook up the M&M.
        - The damages were calculated by looking at the difference in value of the M&M before and after the trespass (usually it would be nothing as the minerals would just be rattled)
        - Found liability for trespass for 2 reasons:
            - Direct interference with mineral estate
            - Direct interference with mineral estate provides information
    - **Waiver of tort (Assumpsit):** Rather than sue for trespass (where damages could be zero), a party could seek recovery of the benefits received by the wrongdoer (ie. the reasonable market value of the use and occupation of the property) – what would have been received if there had been a legal contract created
        - Indicated that damages would be calculated by the cost it would have been per acre to explore
            - Per acre price of $20 by the 2,682 acres of land on which the respondents owned the mineral rights and to which the court found appellants' exploration extended to
                - So, the portion of the land that was actually explored
            - Compensation need be paid only for the area reasonably regarded as "occupied" by the survey (including, but not restricted to, the areas from which vibration echoes were actually received), regardless of how many acres the mineral owner would have insisted on including in an agreement had one actually been bargained for
        - There was a finding of liability for trespass, but there was no certain decision as to what process should be followed for setting damages
        - ***Note*:**
            - This could be applied in Canada in a similar situation, but the M&M owner could only sue the geophysical trespasser with respect to the trespass (NOT for conversion of the information or the right to sell it)
            - In AB, we don't see the issue arise as commonly because of the exploration regulations, which appear to overcome the problem in most cases because they stipulate that an explorer must obtain the consent of the owner of the land as well as anyone else whose consent is lawfully required.

- **Holding**
  - The right of exploration is normally attributed to the M&M owner. Therefore, permission must be obtained from M&M owner, and the surface owner's permission is irrelevant. The defendant was held liable for trespass.
- **Ratio**
  - Seismic exploration may constitute invasion of mineral owners' rights
  - Compensation need only be paid for areas reasonably regarded as "occupied" by the survey
- **Notes**
  - Court
    - "Appellants now contend that since in the present instance appellees are unable to establish any damage to their property measured by decrease in market value proximately due to the trespass, no information detrimental to value of appellees' mineral rights having been revealed, they may recover only nominal damages. It appears, however, that Texas belongs to the minority of states that permit a landowner to waive the trespass and sue in assumpsit for the reasonable value of the use and occupation."
      - Assumpsit – seeking damages for breach of an implied agreement for the reasonable value of, and use and occupation of, the land in question
      - The court goes to quite a length to figure the appropriate damages
    - Find liability and send it back to trial
    - We're looking in this scenario at some sort of reasonable use and occupation value
  - How do you maintain a standard trespass action?
    - You need direct, physical invasion of land
    - Has this occurred here?
    - Likely not – seismic shots are just energy; this isn't sufficiently direct or physical arguably
    - Court finds trespass though
  - We don't really have a clear tort that comes out of this

Regulatory Requirements – The Canadian Approach

- **What contribution does the *Mines & Minerals Act* make?**
  - Need a license to conduct exploration activities (s. 107)
- **What contribution does the *Exploration Regulation 284/2006* make?**
  - Consent from owner for exploration is required (s. 8)
    - Owner likely means surface owner; however you likely need permission from both the surface and mines and minerals owner
- **What if you are denied consent?**
  - Severed title example where mineral title held by o/g company, and they want to go on land, **but surface owner says no**
    - Recall you can get access for exploitation (removal of minerals) from the Surface Rights Board, **but you cannot do this for exploration – you need consent from the landowner**
      - Exploitation is possible via an order, exploration is NOT
    - Is the company hooped then? **No**
      - You look at the other places around that land where you can get permission to access
      - A good option is Crown land – easy to get access
      - Your best recourse is to look to **road allowances**
        - A road allowance is a 66 ft reservation that is either owned by the Crown or municipality
        - If a municipality doesn't want to use, it can lease it; for exploration, the legislation makes special circumstances for seismic activity purposes
        - This works because taking a "shot" on adjacent land from a road allowance works just the same (since waves spread out)

Phillips v California Standard Oil Co (1960 ABSC) – Oil Company Liable in Nuisance for Shock Waves Impacting Water Well; Not Found to Be a Trespass

- **Facts**
  - The plaintiff owned a quarter of section of land on which he sunk a water well; an oil company (California Standard) conducted seismic exploration on the boundaries of the plaintiff's property. The vibrations resulting from the shockwaves caused the contamination of the plaintiff's well.
- **Issue**
  - Why couldn't the P's recover for the injury that occurred in just the same way that the P's in ***Phillips v. Cowden*** did?
- **Analysis**
  - In Canada trespass involves a direct, physical entry on the property of another.

        - The vibrations transmitted to the land do not in law constitute a trespass (does not count as physical intrusion)
    - **Nuisance:** An unreasonable and substantial interference with the neighbor's right to reasonable use and enjoyment of their own property.
        - Unlike trespass, in nuisance you have to prove damage to property.
        - Blasting of this kind that interfered with the neighbouring estate by horizontal shocks amounted to nuisance
        - If there was hydraulic fracking that ruined an aquifer on a plaintiff's land, the plaintiff could also claim nuisance as long as damages actually occurred and can be shown
- **Holding**
    - The D oil company was found liable for nuisance; damages of $1,500 were awarded to the plaintiff
- **Ratio**
    - Shock waves are not usually seen as direct enough to constitute trespass but will give rise to a cause of action in nuisance.
- **Notes**
    - This was not a trespass, but a nuisance
        - Energy waves have altered well; loss of amenity

Wassan v California Standard Oil **(1964 ABSC) – Oil Company Cut Survey Line Without Surface Owner's Permission Because Damages for Trespass Were Low/Worth it**

- **Facts**
    - Oil Co. tried to get permission from the owner of the land to cut a survey line. The land owner refused, saying that her husband is the owner and he won't be home for a few days. The land owner did not own the Mines and Minerals rights. The oil company said they do not require the permission of the landowners at CL, and if they are held liable for damages, it would be cheaper to be sued because damages for trespass are low (around $1000 in this case).
    - At trial: trial judge found that the appellants had trespassed on the respondent's land; California Standard appealed the damages award but not the finding of trespass
- **Holding**
    - Appeal dismissed; Actual damages (compensation) and punitive damages were awarded to deter this type of behavior that breached the regulations that required for the surface owner's consent to be received prior to carrying out geophysical exploration
    - Costs awarded by the trial judge:
        - Loss of timber ($1,777)
        - Clean up costs ($680)
        - Loss of a steer (damage to the farmer's fence allowed some cattle to escape) - $150
        - Exemplary damages (punitive damages) - $500
    - All costs were found to be reasonable
- **Ratio**
    - Permission from a landowner is required for exploration of their land; damages provided for the trespass are very low, so there is little deterrence for oil and gas companies
- **Notes**
    - What tort do you bring here?
        - This is trespass
            - There was a B+E, and caused physical damage (trees, fence destroyed; cow escaped)
        - Damages were pretty minimal though
    - Practical lesson?
        - Oil company got exactly what they wanted; $3000 bill was not that much; probably just the cost of doing business
        - For some companies, it might just be worth doing this

2D vs 3D Testing

- 3D testing is much better; allows you to get a better picture of the reservoir

(c) Hydraulic Fractures

Coastal v Garza **(2008 Texas) – Lessors Have Standing in Action in Trespass; However, Fracking Cannot Ground an Action; Precluded by Rule of Capture**

- **Facts**

- Coastal conducted fracking operations on Tract A to recover substances captured in situ within tight shale formation
- Resulted in physical invasion of neighbouring Tract B (owned by Salinas - oil and gas lease with Garza Energy Trust) and drainage of hydrocarbons to well on Tract A
  - Substances in Tract B migrated to Tract A to considerable extent (half a million dollars), then extracted by Coastal Oil
  - Neighbors claimed effective length of fracturing extended onto property
- As mineral lessor, Salinas have royalty interest and possibility of reverter if leases terminate, but no right to possess, explore for, or produce the minerals

- **Issue**
  - Can neighboring landowners (Salinas) take action against company because hydraulic fracturing extended onto their property? Do lessors have standing to assert trespass (or do they need a possessory property right)? Is fracking an actionable trespass?
- **Analysis**
  - Fracking increases well's exposure to the formation, allowing great production
  - Engineers design fracking operation using **three measurements**:
    - Hydraulic length (initial injection of fluid)
    - Propped length (to keep fractures open)
    - Effective length (where substances were actually drained from)
  - Do the Salinas have standing for action in trespass? Yes
    - At common law, trespass also included **trespass on the case** which was not limited to physical invasions of a possessory interest in land, but provided action for injury to **non-possessory** interest (such as reversion)
    - Must demonstrate actual permanent harm that affects value of his interest
      - Salinas alleged actual harm in form of either reduced royalty revenues or loss of value to the reversion
  - Can the Salinas prove damages justifying a remedy? **No**
    - Hydraulic fracturing cannot ground an action in trespass; **precluded by rule of capture**
    - **4 reasons not to change rule of capture** to allow one property owner to sue another for oil drained by hydraulic fracing extending beyond lease lines:
      - 1. Rule of capture already provides full recourse to owner who claims drainage **(drill a well to offset drainage)**
        - Open to Salinas to start extracting what they can
        - If operator isn't producing, you can force lessee to commence action or kick them off and bring in another company
      - 2. While mineral rights owner has a real interest in oil and gas in place, the law of capture is recognized as property right as well
      - 3. Difficult to determine value of oil drained by fracking (below surface), and some drainage is virtually unavoidable
      - 4. Legislature has not seen fit to regulate fracking and no one wants change
- **Holding**
  - Judgment reversed; Salinas could not sustain a trespass action
- **Ratio**
  - Lessor has standing to assert trespass on the case (applies to non-possessory interests such as reversion) where actual harm occurs to interest in land
  - But one property owner cannot sue another for oil drained by hydraulic fracturing; action in trespass is precluded by rule of capture
- **Notes**
  - Salinas were worried about trespass – arguing that they wanted damages since the hydraulic process ended up making the unconventional substances flow from their property onto the neighboring property where it could be extracted
  - Is there anything from the Texas ownership theory that could be an issue?
    - Rule of capture – here, damages weren't recoverable because of this rule (defeasible fee)
  - Example of o/g cases not having a neat relationship with tortious cases

3. ACQUISITION AND CONVEYANCING OF INTERESTS IN OIL AND GAS

1. WHEN DOES A "LEASE" MEAN A PNG LEASE?

The Unique Nature of Oil and Gas

- **Oil and gas is unique, but its conveyancing raises the same suite of issues as with the treatment of other real property: *Statute of Frauds*, *Dower Act*, etc.**
- **Problems:**
  - **(1) Unique statutory provisions applicable to oil & gas**

- **(2) What to do when an estate is involved (limited treatment)**
- **(3) Oil & gas and the Rule Against Perpetuities**
  - Important for grants made before July 1, 1973

- **Consider**
  - **At common law, can you contract with yourself?**
    - No, usually between different parties
  - **What happens in the event that common party contracts are advantageous or desirable?**
  - **An excellent example of this is raised by the unitization situation**
    - **Unitization** – arranging a field of production for efficiency of extraction and one legal entity becomes the operator
    - The operator then enters into contractual arrangements with other parties
    - If that same operator owns the infrastructure or refining plant, then the owner will end up contracting with itself
  - **Validated by s. 10 of the *Law of Property Act***
    - 10(1) A contract is valid and enforceable in accordance with its terms notwithstanding that in or by the contract
      - (a) one of the parties enters into a covenant, promise or agreement with that party and some other person,
      - (b) one of the parties and some other person enter into a covenant, promise or agreement with that same party and a different person, or
      - (c) one of the parties and some other person enter into a covenant, promise or agreement with that same party.
    - (2) A contract, whether in the form of a deed or not, is valid and enforceable in accordance with its terms notwithstanding that a person by that contract ostensibly contracts with that person alone if, in the person's capacity as one of the parties to the contract, the person is acting as agent for some other person.
    - (3) This section applies to a contract that provides for the conveyance of an interest in real or personal property.
  - **See also: s. 79 confirming that an O&G lease is registerable on title**
    - What shows up on property title
      - Easements, mortgages, liens
      - A oil and gas lease is a registerable interest with land titles too (first thing you want to do when you create a lease)
      - You need to deal with these things before you transfer title
      - It's a way of notifying to the world what encumbers a title/protecting interests

Law of Property Act, "Part 7: Mineral Titles Clarification"

- **Mineral declaration section 56(1)** – broad definition of minerals
  - **Each of the following substances that naturally occurs within, on or under land is hereby declared to be and at all times to have been a mineral:**
    - **Anhydrite Gypsum Sandstone Barite Limestone Serpentine Bauxite Marble Shale Bentonite Mica Slate Diatomite Mirabilite Talc Dolomite Potash Thenardite Epsomite Quartz Rock Trona Granite Rock Phosphate Volcanic Ash**
- **Clay and marl section 57** – **not** minerals, and therefore fall to the **surface** owner
  - **(1) In this section, "clay" or "marl" [lime rich mud] does not include any substance named in section 56(1).**
  - **(2) The owner of the surface of land is and is to be deemed at all times to have been the owner of and entitled to clay and marl on the surface of that land, and all clay and marl obtained by stripping off the overburden or excavating from the surface, or otherwise recovered by surface operations.**
  - **(3) The clay and marl referred to in subsection (2) is deemed not to be a mine, mineral or valuable stone but is deemed to be and to have been a part of the surface of land and to belong to the owner of the surface.**
- **Sand and gravel section 58** – **not** minerals, so sand and gravel also fall to the **surface** owner
  - **(1) The owner of the surface of land is and is to be deemed at all times to have been the owner of and entitled to sand and gravel on the surface of that land, and all sand and gravel obtained by stripping off the overburden or excavating from the surface, or otherwise recovered by surface operations.**
  - **(2) The sand and gravel referred to in subsection (1) is deemed not to be a mine, mineral or valuable stone but is deemed to be and to have been a part of the surface of land and to belong to the owner of the surface.**

Hayes v Mayhood **(1959 SCC) – Lease Under the *Devolution of Real Property Act* and *Land Titles Act* Include PNG Leases; Executrix Giving Lease for PNG**

- **Facts**
  - Hayes devised and bequeathed all petroleum and natural gas rights to Frederick Mayhood (1/4 interest), a collection of 8 nephews and nieces (1/4 total) and 1/2 to Mattern.
  - Fred Mayhood (executor of the will) died after Hayes, but before the full transition of the mines and minerals rights was completed.
  - Mayhood's widow (respondent) requested offers to lease the mineral rights to oil companies. She accepted an offer from one of the companies, subject to her securing approval by the Court under the provisions of *The Devolution of Real Property Act*. **The lease was opposed by one of the nephews who owned a 1/28 interest in the mineral rights** (Hayes). The application for the approval of the proposed lease was approved at trial and the appeal was dismissed.
  - **The nephew alleges** that**:**
    - **1)** At the time Mayhood's widow sought lessees, she was only a bare trustee of the mineral rights and had no power to dispose of them save by way to transfer to the devisees
    - **2)** The Devolution of Real Property Act did not empower the execution of a document such as she executed because it was **neither a sale of real property, nor a lease of real property;** and that
    - **3)** The agreement was not in the interests and to the advantage of the beneficiaries vested in the estate
- **Issue**
  - Is the document the testatrix entered into properly characterized as a sale or lease of real property?
- **Analysis**
  - ***Berkheiser***
    - In ***Berkheiser***, the court ruled that **PNG leases were best characterized as a profit a prendre or irrevocable license** to search for and win substances named.
    - It was also held here that a "lease" of PNG is not a "lease" in the ordinary sense as intended under the Devolution of Real Property Act
  - **However**, in AB, this has been modified by the ***Land Titles Act Clarification Act*** (created later in time than the *Devolution of Property Act* - using a later statute to interpret an earlier one is not normally done)
    - It is hereby declared that the term "**lease**" as under in The Land Titles Act and any Act for which The Land Titles Act was substituted includes, and shall be deemed to have included, an agreement whereby an owner of any estate or interest in any minerals within, upon or under any land for which a certificate of title has been granted under The Land Titles Act or any Act for which The Land Titles Act was substituted, demises or grants or purports to demise or grant to another person a right to take or remove any such minerals for a term certain or for a term certain coupled with a right; thereafter to remove any such minerals so long as the same are being produced from the land within, upon or under which such minerals are situate.
  - **Therefore, the "lease" here for PNG is a lease within the meaning of the Land Titles Act**
    - The lower court had the authority to interpret that Devolution of Real Property Act as including leases of PNG
    - **Note that this opens the door to saying that many other kinds of legislation dealing with real property in Alberta can be interpreted in the same way - pursuant to the Land Titles Clarification Act or other Acts**
      - For example, the Minor's Property Act s 2(1) states that the Court, on application, may by order authorize or direct a sale, **lease**, or other disposition of or action respecting property of a minor if in the Court's opinion it is in the minor's best interest to do so
      - It is possible that this section could apply to oil and gas leases as well, following the same logic in ***Hayes v Mayhood***
- **Holding**
  - Appeal dismissed; The lower court had the authority to approve the agreement made between the respondents as being a lease of real property; leases under the Act include leases of PNG
- **Dissent**
  - Section 11 of the Devolution of Real Property Act **prevents an executrix from disposing of real property in a way that is not to the advantage of the estate and the persons beneficially vested therein.**
  - In this case, the **executrix did not take adequate steps to endeavour to dispose of this property, even assuming she had the right to do so.**
    - The executrix could have undertaken a geological study to determine the value of the mines and minerals resources, or canvas for opinions on the productive capacity of the property and seek out more buyers, but she did not.
      - She essentially gave up these resources, to the beneficiaries' detriment, without getting an adequate return.
    - There was also no term in the lease that would force the oil company to develop the resource or protect drainage of estate lands to neighbouring wells, which does not maximize the benefit to the beneficiaries in the will
- **Ratio**
  - "Leases" under the *Devolution of Real Property Act* and *Land Titles Act* in AB include PNG leases
- **Notes**
  - **The Devolution of Real Property Act has been replaced in Alberta by the Estate Administration Act, SA 2014, c. E12-5.**
    - This Act **cures the actual problem that occurred in *Hayes*** by providing that an **Executor has all the powers of a natural person with the core diligence and skill of a person of ordinary prudence.**

- **Recall: *Berkheiser v Berkheiser* (p. 139)**
- **Facts: Will of one John Wellington Hayes**
  - Testator who creates a will
    - ¼ to Fred, ¼ to 8 B's, ½ to Gertrude
    - Fred dies – he was the executor, so the wife steps in to take over affairs; has to deal with the mess
    - Wife, to realize benefit, starts to solicit interest from different o/g companies to enter into lease
    - Her and the ½ owner (75%) agree with one of the offers; now want to get it approved by the court
    - Go to court to get approval pursuant to DORPA
    - Challenge is made by 1 of the 8 ¼ owners – challenges ability of executrix to enter into the agreement, and the court being able to approve it
- **Issue: Did the "lease" in question qualify for the purposes of the *Devolution of Real Property Act*? Could the executrix execute it and the court approve it?**
- **Reasoning & Conclusion**
  - Challenge is that the DORPA requires a sale of real property or a lease of real property – is an o/g lease a lease of real property?
  - ***Berkheiser*** – o/g leases are profit a prendres
  - The DORPA does not set down a definition of leases; let's look to other statutory language…
  - LTACA – an act that deals with similar subject matter
    - An o/g lease qualifies as a lease
  - Thus, the executrix can execute the agreement, and the court can in turn approve it
- **Dissent: contests whether the agreement is to the advantage or in the interest of the estate/beneficiaries**
  - Challenges validity on other grounds
    - Like, this isn't a beneficial arrangement
  - There was very limiting canvassing for interest – only talked to a couple o/g companies

2. LIFE ESTATES

Introduction

- **Typical Prairie Will**
  - **"I leave everything to my beloved ____ [husband/wife/partner] to enjoy for so long as they live or until they remarry [life estate]. Upon their passing, everything passes to _____ [children/someone else]"**
- **Life Estate**
  - **Does NOT get the full bundle of property rights. Generally, get full use and enjoyment subject to wastage limitation**

Re Moffat Estate (1955 SKQB) – Life Tenancy vs Remaindermen Holding Interest in Mines and Minerals; If Leased and Drilled After Testator's Death…

- **Facts**
  - Myrtle Moffat is a life tenant, and her two sons (Graeme Moffat and Herbert Moffat) are remaindermen for the mines and minerals royalties pertaining to leases on two portions of land in the same section. Three oil wells were drilled on the land, and leases were entered into with Oil companies to produce the oil **after the testator died** (husband)
- **Issue**
  - Who should receive the royalties: The life tenant or the remaindermen?
- **Analysis**
  - **English common law**
    - Indicates that minerals (which are irreplaceable) should benefit the person who is intended to eventually take the ultimate interest in the property (that is, the remainderman).
    - **If lease precedes the death of the executor of the will:** If the land already had active mines when the person with the life estate took their interest, the person with the life estate could continue to operate and benefit from those mines.
  - **Application to this case:** The remainderman is entitled to the minerals since the wells were opened **after** the testator's death. The life tenant enjoys exclusive possession of the surface for her life
    - The remaindermen cannot work the minerals without the life tenant's consent, nor can she drill for oil on the said lands. **Both parties need to consent to these operations.**
      - The life tenant and the remainderman may jointly execute a valid lease (and decide between them how the proceeds are to be divided).
    - Also, the life tenant can claim the income earned on the proceeds derived from the mines and minerals leases.

- **Note:** Deferral rental payment: An annual rental payment made every year that the oil and gas company on a lease has not begun drilling and producing on the lease

- **Holding**
  - The proceeds from the oil lease should be invested in a trust account, with interest on the proceeds payable to the life tenant for the duration of her life. The remainderman will obtain title to the principle proceeds once she dies. The life tenant is also entitled to compensation for any intrusions on her surface rights.
- **Ratio**
  - For life estates, the life tenant is entitled to the income earned on the proceeds received from PNG leases, and the remainderman is entitled to the principle (corpus) proceeds upon the death of the life tenant.
  - If the lease was entered into *before* the death of the testator, the life tenant has the exclusive right to the entirety of the benefits from the lease.
  - No agreements to exploit oil and gas rights can be entered into without the acquiescence of both the life tenant and the remainderman.
- **Notes**
  - **Facts**
    - Will that creates LE situation (wife gets farm as long as she's alive or faithful), then it transfers to 2 sons (remainder people)
    - Asks for court's guidance for what to do with the leases
    - There are 2 leases in question – one that covers each son's quarter-section; there is also money to deal with
    - Parties want to enter into o/g lease
  - **Issue – as between LT and RP, who gets what?**
  - **How is the lease construed by the court? (p. 143)**
    - Profit a prendre
  - **How does English common law treat this? (Lord Blackburn, p. 143)**
    - Takes colonial perspective – what we're looking at is the produce of the farm
      - Analogy: If you were dealing with an apple orchard – who gets what?
        - The mom gets the bounty from the land on a year to year basis
        - The limit: She can't destroy the crop or tear down the orchard – she has it in trust
      - What's the difference between o/g and apples: Apples grow back; so how this difference treated?
        - You can have these leases; when you create them, the money that comes out is going to be deposited into a trust; every year this will generate interest; the LE gets to benefit from the interest, but cannot destroy or take away from the capital; at the termination of the LE, then the whole capital is what transfers to the remainder person
  - **Significance of timing of the lease (p. 144)**
    - Would this change if Mr. M had entered into the lease after he created the will but **before he died?**
      - Yes, intention is changed
      - Mr. M would have intended that all the benefit be to the LE holder
    - Here, it's **after** he died

3. PERPETUITIES

The Perpetuities Problem

- ***Canadian Long Island Petroleums Ltd.* (1975, SCC)**
  - **"The underlying reason for and purpose of the rule is to avoid fettering real property with future interests dependent upon contingencies unduly remote which isolate the property and exclude it from commerce and development for long periods of time, thus working an indirect restraint upon alienation, which is regarded at common law as a public evil."**
- **The Perpetuities Issue Arises in Two Key Situations**
  - 1) ***Options for renewal* – action at the conclusion of the primary term of an oil and gas lease (the "improper renewal clause" scenario)**
  - 2) ***Interest in waiting* – another interest in land to vest upon the termination of an existing lease (the "top lease" scenario)**
    - **Top lease** = interest that you caveat on title which says that in the event the first lease terminates, the top lease vests
      - Effect: The first party can no longer amend their own lease as soon as its topped
- **Common Law Rule**
  - **No future interest is good unless it must vest, if at all, not later than 21 years after some life in being at the creation of the interest**
  - **Usually no life in being for commercial interests. Therefore, to vest no longer than 21 years after the interest's creation**
  - **Can try to circumvent by inserting a life in being clause (see p.147)**

        - "Notwithstanding anything elsewhere herein contained, but subject always to the Regulations relative to the laws of perpetuities as they relate to the joint lands, the right of any party to acquire any interest in the joint lands from any other party hereto shall not extend beyond twenty one (21) years after the lifetime of the last survivor of the lawful descendants now living of Her Majesty Queen Elizabeth II."
            - This could extend it for a very long time
- **A Vested Interest is one that Is…**
    - **Not subject to any limitation/condition on enjoyment, save the termination of a previous estate (i.e., reversionary interest may be subject to a life estate)**
    - **3 qualities of a vested interest:**
        - **1. Recipient is ascertained**
        - **2. Size of the estate is ascertained**
        - **3. Recipient does not have to do anything further for it to vest (i.e., no conditions precedent)**

Modification (But Not Abolishment) of the Common Law Rule in Alberta by the *Perpetuities Act* - Overview

- **s. 3 – not void by virtue of contingent interest vesting beyond perpetuities period**
    - Conveyance not void even if there's a possibility of vesting outside the perpetuities period…
- **s. 4 – "wait and see"**
    - The law will wait and see if the interest becomes vested
- **s. 17 – does not apply to reversionary interests/renewal of true leases**
    - Landlord/tenant leases are true leases, so the RAP doesn't apply
    - Oil and gas leases are **not true leases**, so the RAP applies
- **s. 18 – 80-year statutory perpetuities period for commercial transactions (including *profit a prendre*) (i.e., wait and see for 80 years)**
    - Need to wait 80 years to see if the interest becomes vested
- **s. 25 – common law applicable to interests created before July 1, 1973**
    - Look to CL when looking at issues from before this date

The Perpetuities Act Provisions

- **Rule against perpetuities**
    - 2 Except as provided by this Act, the rule of law known as the rule against perpetuities continues to have full effect.
- **Possibility of vesting beyond period**
    - 3 No disposition creating a contingent interest in real or personal property shall be treated as or declared to be void as violating the rule against perpetuities by reason only of the fact that there is a possibility of the interest vesting beyond the perpetuity period.
- **Presumption of validity - "Wait and See"**
    - 4(1) Every contingent interest in real or personal property that is capable of vesting within or beyond the perpetuity period is presumptively valid until actual events establish…
    - Don't treat limitations creating contingent interests as invalid for violating the rule against perpetuities based upon the possibility of that interest vesting outside the perpetuity period
        - 1. Calculate the perpetuities period by references to the statutory lives in being
        - 2. Wait and see whether actual events establish,
            - That remote vesting is impossible, in which case the interest is valid; or
            - That the interest will not vest in time, in which case the interest is void unless it can be saved by sections 6, 7, or 8
- **Options to acquire reversionary interest**
    - 17(1) The rule against perpetuities <u>does not apply to an option to acquire for valuable consideration an interest reversionary on the term of a lease or renewal of a lease</u>, whether the lease or renewal is of real or personal property,
        - (a) if the option is exercisable only by the lessee or the lessee's successors in title, and
        - (b) if it ceases to be exercisable at or before the expiration of one year following the determination of the lease or renewal.
    - (2) Subsection (1) applies to an agreement for a lease as it applies to a lease, and "lessee" shall be construed accordingly.
    - (3) Subsection (1) applies to a right of first refusal or pre-emption as it applies to an option.
    - (4) The rule against perpetuities <u>does not apply to options to renew a lease of real or personal property</u>.
- **Commercial transactions**

- 18(1) In the case of a contract whereby for valuable consideration an interest in real or personal property may be acquired at a future time, **the perpetuity period is 80 years from the date of the contract**, and if the contract provides for the acquisition of such an interest at a time greater than 80 years, then the interest may be acquired up to 80 years and not afterwards.
- (2) In particular and not so as to restrict the generality of subsection (1), that subsection applies to all contracts relating to a future sale or lease, to options in gross, rights of pre-emption or first refusal and to future profits a prendre, easements and restrictive covenants.
- (3) This section does not apply to any provision in a will or inter vivos trust.

- **s. 11 remedial provisions of the Act shall be followed in the order below:**
  - S. 9 – reproductive assumptions
  - S. 4 – wait and see
  - S. 6 – reduction of age
  - S. 7 – exclusion of class members to avoid remoteness
  - S. 8 – general cy-pres to honour intentions as best as possible
- **s. 5 – lives in being and the perpetuity period**
  - 1. In being and ascertainable at the outset
  - 2. Not too numerous that makes it difficult to identify the last survivor
  - 3. Within class of persons referred to in s 5(2)
- 5(1)(b) if there are no lives under clause (a), the perpetuity period is 21 years.
- 5 (2) The persons referred to in subsection (1) are as follows:
  - (a) the person by whom the disposition is made;
  - (b) a person to whom or in whose favour the disposition was made, that is to say,
    - (i) in the case of a disposition to a class of persons, any member or potential member of the class;

Canadian Export Gas & Oil Ltd v Flegal **(1977 ABSC) – Perpetual Renewal Clause in PNG Lease Found to Violate the RAP**

- **Facts**
  - Defendants are successors in title to a lessor who had given the plaintiff's assignor "the opportunity to locate a lessee" from PNG. The plaintiff's assignor took a petroleum and natural gas lease and grant as "lessee." The lease was made on 1 October 1964 and was for a term of 10 years. The lease contained a provision that on the expiration of the primary term hereof, **if the lease substances or any of them are not being produced on the said lands, the Lessee shall have and is hereby granted the sole exclusive option to renew the lease for a further 10 years**. This renewal can be invoked repeatedly at 10 year intervals.
    - So the lessee could decide to renew the lease every ten years without producing from the lease
- **Issue**
  - Was the right to renew enforceable by the lessee? Is this option clause void because it is contrary to the common law rule against perpetuities?
- **Analysis**
  - **Plaintiffs**: The plaintiffs urge that the rule is not engaged because it does not apply to option clauses, and even if it were engaged, the first two renewals must occur within the perpetuity period (admittedly 21 years) and the option is valid to that extent.
    - The plaintiff also urged that a perpetual renewal provision contained in a lease does not fall within the rule - it is a kind of interest that the rule was never intended to proscribe. Rationale posed for this differentiation is that the interest is a PRESENT vested interest, as opposed to a FUTURE interest (which is what is caught by the rule against perpetuities).
    - **Judge says:** This kind of renewal we are concerned with here must be justified as an **exception** to the rule and **is not a present vested interest to which the rule does not apply**
  - **Defendants:** Defendants urge that the "lease" is not a true lease and the inapplicability of the rule to renewal clauses in leases is not appropriate to the renewal of profit à prendre. They urge that if the rule does apply the entire renewal provision is void.
  - **Academic commentators:** Suggest that options to renew in leases should not be subject to the rule against perpetuities because such options do not engage the fundamental purpose of the rule - that is, they help to stimulate, not retard, the commercial and economic development of the land in question
  - **Judge**
    - The **judge does not agree with this characterization** occurring in this case since the **perpetual renewal option in this case actually sterilizes the land**.
    - **Traditional lease for real property vs profit a prendre:**
      - There is already some kind of vesting in a normal lease of property because the lessee is already occupying that which is subject to the rental agreement
      - The Court says that this situation is not akin to a true lease; an oil and gas lease is a profit a prendre
      - The **lessee does not take any interest prior to the lease being acted upon**
  - **Therefore, the rule should apply.** However, is it violated?

        - Yes, it allows for the perpetual renewal of the lease, which is not permitted by the rule.
        - The agreement is therefore void ab initio because the courts cannot rewrite or sever a term of the contract. The entire lease contract therefore fails.
        - **Argument that the option can be acted upon within 21 years:**
            - It still violates the rule against perpetuities because the possibility still exists that the interest could vest outside of the 21-year period
            - Before the lease came into effect, the lessee was required to notify the lessor and pay a fee, which looks like a condition precedent, adding to the support for applying the rule
- **Holding**
    - The perpetual renewal clause for a PNG lease is subject to the common law rule against perpetuities, and therefore, the lease is void for being contrary to the rule (the interest may vest outside of 21 years)
- **Ratio**
    - The rule against perpetuities will apply to option to renew clauses in PNG leases that allow the options to continually be exercised ad infinitum.
        - The option itself is an interest that must vest within the perpetuities rule
- **Notes**
    - **Facts**
        - Option to renew clause (renew on the same terms) (p. 147)
        - Section 15 of agreement:
            - 15. Surrender or Extension . . . **Always provided that on** the expiration of the primary term hereof, if the lease substances or any of them are not then being produced on the said lands, the Lessee shall have and is hereby granted the sole exclusive option to renew the within Lease for a further primary term of 10 years to commence as of the date of termination of the within Lease, subject to the same terms, covenants and conditions as are herein contained including this covenant for renewal. This option shall be open for acceptance for a period of 30 days immediately following the expiration of the primary term hereof, and may be exercised by notice in writing to the Lessor given in the manner herein specified, accompanied by the Lessee's cheque for the same amount as the cash consideration for this Lease.
        - *What has to happen during the primary term of the lease?*
            - *Not much; it's just the window for the lessee to initiate operations; if they don't, they need to pay*
        - Here there is a lease with perpetual renewal on the same terms
        - Lessor upset that they're not making much money from this arrangement; challenge lease on grounds that it violates RAP
            - Arguments that it doesn't violate RAP
                - Renewal options aren't subject to the RAP
            - Arguments that it violates RAP
                - This lease is not a true lease, and therefore the CL exception is inapplicable; we're talking about the renewal of a profit a prendre
    - **Issues**
        - Right to renew void for violation of the R v. P? (p. 147)
    - **Principled analysis**
        - Not a true lease/not vested with Lessee/effect of perpetual renewal?
        - Strike down and not re-write to fit within the 21 year period
        - When you renew a true lease, it's akin to the land being used
            - An o/g lease is different
        - A profit a prendre shouldn't be exempt from the RAP – you have a minimal payment rather than a full payment that will only occur when you move beyond the primary terms into the actual working of the property
        - On final argument of having at least one renewal: Denied; still exists the possibility of it vesting outside the period; not the court's job to re-write the agreement
        - Lease terminated

PanCanadian Petroleum Ltd v Husky Oil **(1994 ABQB) – Perpetual Option to Renew Lease Void if Not Currently Producing; Follows *Flegal***

- **Facts**
    - Two leases (Shallow rights and Mineral; signed in 1967), in their habendum clause, fixed the primary term for 25 years. The leases would continue in their secondary terms in the event of continued production beyond the primary term, ***subject to the sooner termination of the said term, and subject to the renewal of the said term.*** The renewal clause provided that the renewed lease must be identical to the original lease in all respects, including the renewal clause. The defendant lessee (Husky) tried to renew the lease, but the plaintiff lessor (PanCanadian) refused, stating that the renewal clause violated the rule against perpetuities.
    - There was continued production on the Shallow Rights lease, so the lessee argued that the renewal clause should not apply since it only comes into play if there is no continued production on the lands. The Shallow Rights Lease was in production even before the grant of lease. The Mineral Lease never produced leased substances.

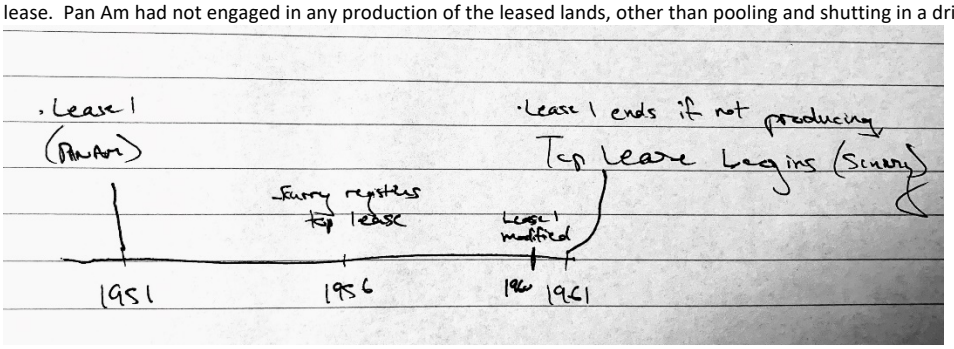
- **Argument of the lessor:** although the Shallow Rights Lease was in production, it was still subject to renewal in order to preserve the lease, despite the continued production.
  - Mere production was not enough to keep the lease alive. And since the renewal clause offended the rule against perpetuities, both the producing and non-producing leases were void.
- **Husky (lessee) argued:** that renewals of profit a prendre interests should not violate the rule against perpetuities because they are akin to renewals of landlord/tenant relationships, which are beyond the scope of the rule.
  - *The court disagrees with this - following **Berkheiser**, PNG leases are properly characterized as profits a prendre and not as landlord/tenant.*
  - *The right to renew a profit à prendre is not a vested interest.*

- **Issue**
  - Does this violate the RAP, and if so, does it apply given the production on the lands?
- **Analysis**
  - **Shallow Rights Lease:** The Shallow Rights lease was being produced; it therefore does not engage the rule (yet) because the renewal is only required if there is no production.
    - The judge said that the "subject to" clause is there to rescue the lease by renewal only when there is no production during the primary term.
    - So the court excised the renewal clause because production was already ongoing
  - **Mineral Lease:** The Mineral Lease is void because there is no current production under that lease, and its perpetual renewal violates the rule against perpetuities.
    - Perpetual renewal of an oil and gas lease **encourages sterilization.**
- **Holding**
  - The renewal clause in both leases violated the rule against perpetuities; however, the lease that was currently under production (the shallow rights lease) did not engage the rule against perpetuities because the renewal clause did not come into play, as the lease was already under production
    - The renewal clause was only to be used when no production had occurred
    - The mineral lease was void by reason of the perpetual renewal clause violating the rule against perpetuities, as it was not yet producing
- **Ratio**
  - Following ***Flegal***, a perpetual option to renew a profit-a prendre which is not currently producing violates the rule against perpetuities and is therefore void *ab initio*.
- **Notes**
  - **Facts**
    - Shallow Rights Lease (in production); Deep Rights Lease (not in production) (p. 151)
      - Shallow lease has been the productive one
      - Deep lease is not developing; only been minimal payment on it
    - Imagine Husky Oil's shock (280 wells with proven production and 12 million paid in delay rentals)!
    - Renewal clause (*language seems to violate the RAP*)
  - **Issues**
    - Habendum Clause + Renewal Clause
  - **Reasoning (pp. 152-153)**
    - Vested without conditions? Condition Precedent or Subsequent? "True" lease renewal or not?
    - Court
      - For shallow lease, production has commenced and renewal is not necessary since you're in the mode of production – not going to use the RAP
      - For deep lease, we will use the RAP to vitiate the lease
    - Husky has 3 arguments
      - Right of renewal here is a vested interest, and as such we should be allowed to sustain the lease
        - **Court**: No, this is only something that vests with conditions; there were 18 conditions that needed to be satisfied
      - Tried to qualify the conditions as CS rather than CP, to escape operation of the rule
        - **Court**: No, the actions were CP even if fairly insignificant
      - This is true lease renewal, which are exempt
        - **Court**: No, there is no authority that says a profit a prendre is a true lease renewal

Pan American Petroleum Corp v Potapchuk **(1964 ABSC) – Precedence of Caveat Registered on Title; Option for Top Lease Valid; Fixed Term Option Not in Violation of RAP**

- **Facts**
  - Pan Am seeks a declaration against the defendant ("Scurry") that they have a subsisting lease for the mines and minerals under Potapchuk's land, which was assigned by various assignments from Shell in 1956 to them at the present date. The lease was for a period of 10 years commencing in 1951, and therefore terminated in 1961 unless continued pursuant to the agreement. Potapchuk assigned her interest to Scurry and gave Scurry the right to option a lease for the mines and

minerals on the land (this was exercised after the Pan Am lease purportedly expired in 1961). Incorporated in the option agreement, was a lease to be effective on acceptance of the option (AKA, Scurry had a top lease).

- When Scurry tried to exercise his option, Moser informed him that he could not because Pan Am held a pre-existing lease. Moser had previously accepted Pan Am's offer to pool her lands with adjacent lands and to shut in the wells on her lands. The contract with Pan Am had been "clarified" or "modified" by a letter in 1960 that suggested that pooling of the lands and shutting in wells would be considered "active production" on the Pan Am lands, sufficient to extend Pan Am's lease. Pan Am had not engaged in any production of the leased lands, other than pooling and shutting in a drilled well.
- 

- **Issue**
  - Can Pan-American "clarify" what was originally meant by "active production" in the 1951 lease such that pooling the lands will satisfy this requirement? If not, does the top lease (held by the defendant, Scurry) violate the rule against perpetuities?
- **Analysis**
  - **The defendant, Scurry, argued:** that the Shell lease has expired, because no well was drilled on the said lands nor was drilling proceeding thereon, nor was production being obtained on said pooled lands at the date of the expiration of the primary term of the Shell lease
  - **Active Production?**
    - In *Gunderson*, the court found that pooling lands with adjacent lands did not constitute "active production" to continue the lease under the same wording as the Shell lease in this case.
    - Also, *Gunderson* held that capping a well on the lands in question means that the well is not "actively producing" - so it cannot extend the term of the lease.
  - **Priority once caveat registered on title**
    - In this case, Scurry's five-year option was protected by registering it as a caveat on title in 1956. It was exercised in 1961, after the subsisting Pan Am lease had expired but before the five year option period had ended.
      - **Once you register a caveat on title, that prevents subsequent interests from being registered which derogate from that interest (the first caveat always takes priority).**
    - The contract (modification to the lease) was drafted in 1960 which purportedly clarified what was meant by "active production" under the original 1951 Pan Am lease. This was not a clarification of an existing term, but was instead a modification of the contract.
      - Since the **modification occurred after Scurry registered his interest in the caveat, Scurry's interest takes priority.**
  - **Top lease violates Rule against Perpetuities?**
    - Pan Am contends that the Scurry caveat violates the RAP because it would automatically be extended to include any time that Pan Am breaks its lease. That is wrong.
    - The lease with Scurry says that acceptance was open for five years, and there was no renewal option (fixed term option)
      - In the alternative, if the option can be extended indefinitely, **it does not violate the RAP because the optioner has the right to terminate the option at will.**
- **Holding**
  - In favour of the defendant, Scurry. Defendant has a valid lease in the mines and minerals as the plaintiff's lease expired and the defendant exercised their option for a lease. A caveat on title for an option for a top lease added subsequently to a lease will have the effect that the initial lease can no longer be modified.
- **Ratio**
  - An interest registered on title as a caveat will take precedence over any subsequent registration of an interest which otherwise derogates from that caveat (e.g. registering an option for a lease takes priority over a modification of the original lease).
  - If the right to option a lease clause does not explicitly allow for subsequent renewals (fixed term option), then it will not violate the rule against perpetuities
    - In the alternative, if the option can be extended indefinitely, **it does not violate the RAP because the optioner has the right to terminate the option at will.**
- **Notes**
  - **Facts**

        - Between competing lessees (first in 1951, second in 1956); attempt to amend the topped lease and arises out of complex litigation playing out in the background surrounding "deemed production" (to be discussed later)
        - Initial lease period for 10 years
        - Lease terminated on 1961, unless production was able to occur; it didn't
        - Partway through bottom lease, lessor enters into a top lease, which gives an irrevocable option for 5 years on the minerals
        - Argue that the top lease was invalid because of the uncertainty of it vesting
    - **Issues**
        - Caveated—to protect and declare—equitable reversionary interest; freezes the status of interests registered above (p. 153)
    - **Reasoning**
        - There is a top lease, but the period it's going to be operational for is 5 years; there is no language trying to extend this
            - The period is ascertainable, and within 21 years, and nothing to signal that its operating to achieve a perpetuities violation
            - There was no perpetuities issue

Scurry-Rainbow Oil (Sask) Ltd v Taylor (2001 SKCA) – Top Lease Does Not Violate the RAP for Policy Reasons

- **Facts**
    - In 1949, Taylor (father of the respondent) granted a ten-year primary term lease to Imperial Oil for PNG. Under the habendum clause, the primary term was for ten years and for so long thereafter as leased substances are produced from the lands. There was no production and the lease expired at the end of the primary term in 1959.
    - In 1950, father Taylor signed agreement called "Assignment and Conveyance of PNG Royalty and Lease of Minerals" where he granted a top lease for PNG on the same lands to Freeholders Oil (later merged with Scurry-Rainbow) upon the expiration of the Imperial Oil lease. The top lease provided that the option could be exercised anytime within 42 years, and that lease would last for a period of 99 years which was renewable at the option of the grantee. This top lease is now being challenged for violating the rule against perpetuities.
    - Note that Imperial executed a Top Top Lease so that their interest would be protected in the event that the Freeholder top lease is voided.
    - The trial judge held that the Freeholder top lease was void because it contravened the RAP
- **Issue**
    - Does the top lease signed in 1950 violate the RAP?
- **Analysis**
    - **Top leases**: "Top leases" are common in the oil and gas industry - they are secondary leases which activate if an existing lease is repudiated or expires.
    - **Purpose of the Rule Against Perpetuities:**
        - The **fundamental purpose of the RAP** is to **prevent the fettering of the marketability of property** over long periods of time by indirect restraints upon its alienation.
        - The rule applies without regard to intention - it does not matter if the parties agree to a contract which violates the rule, the rule voids the contract ab initio.
    - In the case of top leases, they are accepted as normal business practice in the oil and gas industry because they **increase actual drilling and competitiveness.** Oil companies who have existing leases that are topped by others are more likely to drill the land themselves to prevent a competitor from taking the lease from them later.
        - Therefore, the Scurry-Rainbow **top lease does not engage the underlying rationale of the rule against perpetuities since it encourages the economic development** of the land (that is, the provision does not clog alienation).
        - The rule against perpetuities never contemplated top leases, and it could not have been intended to apply to these types of transactions. Therefore, the rule is not violated.
        - ***Archaic rules of common law must be re-examined in light of modern realities to determine if they should be modified.***
    - Note: 21 years was the perpetuities period here because there was no life in being
        - There were thousands of top leases in Saskatchewan that could have been made much more uncertain if the rule was strictly applied
- **Holding**
    - Appeal allowed; the top lease held by Scurry Rainbow (previously Freeholder) is valid because it does not violate the purpose behind the RAP
- **Dissent**
    - The top lease violates the common-law rule against perpetuities. Courts have always exercised extreme caution in applying legal rules to real property disputes. There are hundreds of similar leases that could be affected by modifying the rule against perpetuities.

        - Modifying the rule should be left to the legislature; it is not the purview of the courts to put forward such a drastic and far-reaching change in law.
- **Ratio**
    - If the purpose of a lease is to encourage the economic development of the land, then it may be exempt from strictly applying the RAP (because it is aligned with the purpose of the rule); such is the rule for top leases
- **Notes**
    - **Facts (p. 156-157)**
        - Farmout operator becomes competitor
        - Rogue actor takes advantage of a farmout position they're put in, to assess the validity of a lease
        - Assess it, and take the position that the lease terminated because of a RAP violation, and then they turn around and become a competitor by entering into their own lease
    - **Issues**
        - Is the top lease invalid for violating the R v. P?
    - **Reasoning**
        - Lease has reference to a 42 year period and 99 year arrangement – does this violate the perpetuities: Yes
        - Should it be invalidated though: **No**
            - Disregards the principled approach from the previous cases, and looks at the policy purpose behind the RAP: For the land to be put to use and engage with commercial activity
            - The CL is also pretty fluid – there are examples of not following precedent when there's justification
            - Here, these top leases will be validated even if against the RAP, because top leases serve a purpose of stimulating development – if there are other parties waiting to engage, this will motivate the bottom lease to stay functioning

4. Tenants in Common

Overview

- ***Tenants in common*** – concurrent ownership of real property; each holding an individual, undivided ownership interest in the property. This means that each party has the right to alienate, or transfer the ownership of, her ownership interest
- ***Joint tenants*** – co-owners with right of survivorship; equal ownership with an equal right to the whole property. Upon death, property is excluded from the estate and passes to the surviving joint tenant
- **O&G Lease:**
    - Tenants in common don't need consent to execute a lease but obligated to account for the profits
    - Under a joint tenancy, consent needed and no separate leases allowed

4. THE FREEHOLD LEASE

0. Overview – Anatomy of the Freehold Lease

Introduction

Bishop vs CAPL99 Lease

- Bishop Lease
    - Sets out all the traditional terms; less standardized
- CAPL99 Lease
    - This was an effort by petroleum producers in association with landowner interest groups to standardize lease language – "A standard form"

Introductory Comments

- **Its true nature: *profit a prendre* (incorporeal hereditament) or irrevocable license to work *(Berkheiser* etc.*)***
    - This could be changed by a statute though
- **Leases commonly survive through the primary term and well beyond by virtue of continued production (how is this defined?)**
    - Leases anticipate a lengthy term

    - Primary term – phase the lessee has to get working on the land
    - Secondary term – when you transition into production, and you're moving forward
        - This could last a long time
- **Practical issue: more difficult to pause/stop gas production than oil production**
    - An oil well can be produced and put into storage in order to prove production. This cannot be done with a gas well, as they are connected to pipelines.
- **Do the lessor and lessee have the same interests?**
    - At the core, the issue it to have a profitable relationship
    - This could look different though for a lessor vs a lessee
        - Lessee – produce where the royalties they need to pay are the least
        - Lessor – want development now that is profitable and competitive
    - Mutual goal of profitability, but not necessarily the same indicia
- **Who brings the lease to the table?**
    - Usually the o/g company is who comes armed with the lease
    - They bring a lease with terms most favorable to their position
        - AKA a lease with a long primary term (longer period time to not produce); favourable definitions; a good royalty calculation scheme
- **CAPL99 Lease**
    - **Call for lease standardization in the 1980s**
        - 2nd major standardized form we have
    - **Joint committee: CBA Natural Resources Section + Canadian Association of Petroleum Landsmen (CAPL)**
    - **CAPL88 – operator protectionist**
        - Guarded the interest of the o/g companies quite significantly
    - **CAPL99 – more of a compromise, but still operator-friendly**
        - Takes into account more interests of landowners
    - **Lesson: freeholders should not accept CAPL99 pro forma**
        - Even if it's a CAPL99 lease, you should still review and make amendments to the best of your abilities as an owner

Anatomy of the PNG Lease

1. The Granting Clause

- **Lessee obtains right to seek and extract the named substance(s) on named land(s)**
- **Legal description of the SUBSTANCES and the LANDS**
- **What substances have been conveyed?**
    - **What is petroleum?**
        - Liquid HCs?
    - **What is natural gas?**
        - Solution gas? Evolved gas? Primary gas cap gas?
    - **Where does coalbed methane fit?**
        - You want to declare this explicitly
    - **Look to "Interpretation" section for guidance**
        - This section should define the above terms to ensure clarity
    - ***See* Bishop Lease and CAPL Lease**
        - Bishop
            - Gives us description of substances in granting clause
        - CAPL
            - Granting clause is using defined terms
            - Very broad description, compared to what we see in the Bishop lease
                - This is a trend to use a broad and strong interpretation section
- Example
    - "DOTH HEREBY GRANT AND LEASE Unto the lessees all the petroleum, natural gas and related hydrocarbons (except coal and valuable stone)."

2. The Habendum Clause

- **Specifies, limits, and defines the duration of the granted interest ("To have and enjoy…")**
- **Primary Term and Secondary Term (Extended/Production Term) will usually be defined**
- **No Canadian common law definition of "Production"**

- A sophisticated lessor/lessee will therefore insert a definition
- Bishop
  - No definition of production, but does have "commercial production"
- CAPL
  - Definition of "commercial production"

- **Common Primary Term lengths**
  - Want them short if you're the lessor; likely 2-5 years
  - If a lessee, you want some more flexibility of managing your profitability; likely 5-10 years
- **"…the lease will be extended so long as there is operations"**
  - An issue that will arise is getting a lease to extend
  - Leases also won't be identical in how they transition from primary to secondary term
  - Need to focus on language that will allow a lease to survive
- ***See* Bishop Lease (+ Proviso 3) & CAPL99 ("Operations")**
  - Bishop
    - Primary term – 10 years
    - Produced: Not defined
    - This is a brief habendum which speaks to production, then has provisos (3)
      - Proviso 3: At the end of the primary term there's no production but they're working and doing operations to save production OR they're trying to maintain and pursue the lease within 90 days of cessation
      - Provisos are more common in older leases like Bishop; not as many in CAPL
    - The junction between the primary and secondary term will be a great opportunity to kick off the lessee; there's very little that needs to be met
  - CAPL
    - More sophisticated lead-in to the full habendum
    - Operations: Defined in 1(i)
      - Super broad → benefits the lessee
- Example
  - "TO HAVE AND ENJOY the same for the term of 10 years from the date hereof and so long thereafter as the leased substances or any of them are produced from the said lands, subject to the sooner termination of the said term as hereinafter provided."
    - The primary term here is 10 years
    - The extended term is how long the lease can continue after the primary term expires, ie. "as long as the leased substances are produced"

Habendum Proviso 1: The Delay Rental Clause

- **Lessee to pay the Lessor for failure to drill a well within a specified period of time**
- **5 year Primary Term, 4 Delay Rentals**
- **Strictly construed (Query: can you mitigate with a default/breach clause? See: Clause 18 of Bishop lease)**
  - Bishop
    - 10 year primary term
    - Possibly 9 delay rental payments that can be made
    - Anniversary date – when would you have to make sure Bishop had payment of $160?
      - 11:59 on March 15, or else it will terminate
    - Clause 18 – If there is non-observance of an obligation, the lessor has to notify the lessee, and they get a curing period (in this case 90 days)
      - Intended to benefit the lessee
- **Cannot be used to extend the lease beyond its Primary Term**
- **Common Delay Rental Clauses**
  - **Designed to get operations underway**
  - **1) The "Unless" Clause – condition precedent**
    - "The lessee may defer operations for one year if it pays a delay rental. The lease will terminate unless the payment is made. If payment is not made, the lease automatically terminates."
      - If payment isn't made, the lease terminates
  - **2) The "Drill or Pay" Clause – contractual breach** (more generous to the lessee)
    - "The lessee shall pay a delay rental if there is no production after one year. If it does not pay, it is in default and there is a cure period during which it can rectify/remedy the situation." → initiates default clause
      - This requires the lessor to notify the lessee of the breach, and the lessee then has a specific period of time to correct the situation. And if they fail to do so then the lease terminates.
  - ***See* Bishop Lease**

        - This is an "unless" clause – more difficult for the lessee to construe this as a contractual breach which would initiate the default clause
        - If payment wasn't made in a timely manner by the lessee, Bishop would have a strong case that there wouldn't be a default under clause 18
- Example
    - "Unless we (the lessee) have commenced operations within one year from the date of the lease, the lease shall terminate unless we pay the delay rental of $160 dollars on or before the said anniversary date, and that in like manner and upon like payment, the commencement of drilling operations and the termination of this lease shall be further deferred for like periods successively"

Habendum Proviso 2: The Dry Well Clause

- **In the event that a dry well is drilled or a productive well ceases, the lease shall terminate at its next anniversary date unless a delay rental payment is made**
- ***See* Bishop Lease**
    - "If at any time during the primary term and prior to the discovery of production on the said lands, **the lessee shall drill a dry well** or wells thereon, or it at any time during such term and after the discovery of production on the said lands such production shall cease and the well or wells from which such production was taken shall be abandoned, **then this lease shall terminate** at the next ensuing anniversary date hereof **UNLESS the lessee shall have paid or tendered the delay rental**, in which latter event the immediately preceding proviso hereof governing the payment of the delay rental and the effect thereof shall be applicable thereto"
    - E.g. On Year 2, you get some production, but then stop some way through the Year 3
        - At that point, if the well is abandoned, you don't have production which won't let the lease continue; rather they'd pay a delay rental to move into the next year or operations for drilling of a further well on the said lands shall have been commenced

Habendum Proviso 3: The Continuous Operations Clause

- **Enables the lease to continue *after* the expiry of the Primary Term if drilling/production has been interrupted by something that is reasonably beyond the Lessee's control**
- **To be read with and balanced against the habendum**
- ***Prima facie* enables continued lease existence without production; often litigated**
    - If you're relying on something short of production, you're going to have to justify it within the lease language; tough for the lessee
- Usually strictly construed, so won't usually favour the lessee
- Example
    - "And further always provided that if at any time after the expiration of the said 10 year term the said substances are not being produced on the said lands and the lessee is then engaged in drilling or working operations thereon, this lease shall remain in force so long as such operations are prosecuted, and if they result in the production of the said substances or any of them, so long thereafter as the said substances or any of them are produced from the said lands, provided that if drilling, working or productions are interrupted or suspended as the result of any cause whatsoever beyond the lessee's control, other than the lessee's lack of funds, the time of such interruption or suspension shall not be counted against the lessee, anything hereinbefore contained or implied to the contrary notwithstanding."

3. The Shut-In Well Clause

- **The purpose is to "deem production" in the situation where the well has been drilled but is not being produced (i.e., actual production has ceased but the lease is maintained by deemed production)**
- **Can only deem production for a reason enumerated in the lease. Common reasons include: lack of market, intermittent market, and reasons reasonably beyond the lessee's control. Again, strictly construed**
- As a lessor, these are important to read, as a broad one could give a lot of leeway to the lessee
- **Trend: strictly construed and requires timely payment (anniversary date – what is it?)**
    - Before midnight of the anniversary date
- ***See* CAPL Lease (Clause 3) & Bishop Lease (Clause 3)**
    - Bishop, article 3
        - If you're in the secondary term but you're not producing, you can pay a sum equal to the delay rental ($160)
- **Examine every lease for:**
    - **What is permissible to deem production**
    - **What constitutes timely payment**

    - **What constitutes an appropriate method of payment**
    - **Prerequisites for shutting in a well**
- Example
    - "If all wells on the said lands are shut in, suspended or otherwise not producing during any year ending on an anniversary date as the result of a lack or an intermittent market, or any cause whatsoever beyond the lessee's reasonable control, the lessee shall pay to the lessor at the expiration of each said term a sum equal to the delay rental hereinbefore set forth, and each well shall be deemed to be a producing well hereunder."
        - This payment is known as a "**shut-in royalty**"

4. The Offset Well Clause

- **Lessor discovers that a neighbour has initiated successful well production – capture**
    - When a lessor discovers that the neighbor has a successful well and they are worried about that well draining the O/G from their land, they can oblige the lessee to drill a well or get off the land (or the lessor owns the adjacent land but another lessee is operating on that land)
- **This is the "drill or get off my land" clause**
    - Essentially gives notice to the lessee under your instrument that they have to drill or get off the land because of what is happening on neighbouring properties
- ***See* Bishop Lease (Clause 8)**
    - 6-month window to get engaged with it or get kicked off
- **Laterally and/or diagonally adjacent? Look to the words of the lease (CAPL99 Clause 6 v. Bishop Clause 8)**
    - Bishop lease – it's just lateral (up/down/left/right)
    - CAPL lease – has diagonals too; better crafted
- Example
    - In the event of commercial production being obtained from any well drilled on any **SU laterally adjoining the said lands and NOT owned by the lessor** (or if owned by the lessor, not under lease to the lessee), then unless a well has been or is being drilled on the SU of said lands laterally adjoining the SU on which production is being so obtained…**the lessee shall, within six months** from the date or said well being placed on regular production either:
        - (a) Commence or cause to be commenced operations for the drilling of an offset well; OR
        - (b) Surrender all or any portion of said lands
- **"Commercial production" is defined. Not as favourable to the Lessor as one might think**
    - Why:
        - We're talking about commercial operations – how do you prove that your neighbor's land has a commercially viable operation? This is usually difficult to show, and thus this clause is difficult to trigger
- **Modern Offset Well Clauses make allowances for Lessees to pool or unitize to offset. They can allocate the lessor's share in a different manner:**
    - 1) Sign agreements that allow the Lessor to get benefits from the "pool" or from the "unit" (CAPL99 Clause 6(b))
    - 2) Pay a compensatory royalty that pays an amount equivalent to what would have been owed if adjacent production was happening on the lessor's land (CAPL99 Clause 6(d))

5. The Pooling Clause

- **Recall:**
    - *Pooling*: combine tracts to form a DSU (voluntary or compulsory)
    - *Unitization*: combine DSUs to form a field (voluntary)
- **"Production on the pooled lands or unitized lands counts as production on the leased/said lands" *or* "production from the said lands or lands which the said lands may be pooled/unitized with"**
- **Solves the *Gundersen/Potapchuk* dilemma**
- See Bishop Lease, Clause 9

6. The Default Clause

- ***See* Bishop Lease**
    - Clause 18
- **Applies to breaches, non-observance, non-performance by *lessee***
- **Requires the lessor to give notice to the lessee (corollary: provides the lessee the right to remedy)**
    - Gives the lessee an ability to rectify any issues that arise
- **Contentious section: does it extend to delay rental/shut-in royalty/offset well clauses?**

- Common interpretation is that the failure to pay delay rental or shut-in royalty is not a breach of contract
  - Common interpretation is that the failure to pay delay rental or shut-in royalty is **not** a breach of contract. if the lessee misses one of the payments, the lessor is not required to give notice that the lease is now ended. Those payments are **options** not terms which will be breached by non-compliance
  - **Breaches apply only to obligations**, not options
    - If you can frame as an **obligation**, then if there's a breach of it, before the lessor can terminate the lease, they'd have to notify the lessee and give them the opportunity to rectify via the default clause (engages default clause)
  - If an **option** (something the lessee can choose to exercise but not mandatory), the default clause does not apply

7. The Manner of Payment Clause

- ***See* Bishop Lease (Clause 22)**
  - Gives language for how the payment should be made and sufficient clarity as to who the depository is
- **Crucial!**
- **Lessor is to designate the depository** (who the lessee makes payments to)
  - Usually a bank
- **Significant consequences associated with payments not being made in a timely manner**
  - Arguably it's an obligation, not an option
- **Some also contain a mailing clause… problematic?**
  - Postal rule – acceptance done once you put it in the mail
  - Does this extend to commercial transactions? → maybe/maybe not

The Lessor's Compensation Package

- **1) Signing Bonus – highly negotiable**
  - Certain amount of money as initial consideration for signing the arrangement
  - In Bishop Granting clause → $1600
- **2) Royalties – moderately negotiable** – o/g company has more skin in the game so less negotiable
  - **"Gross royalty of 12.5% of leased substances"**
    - Gross = you're not taking into account the costs of production (want to limit the ability of the lessee to account for deductions)
    - You don't want a net royalty as a lessor, because then the lessee could reduce the royalty for transportation and refining costs
  - **Paid for preceding month's production**
  - **Current market value at the wellhead (usually not a big problem for oil, which is sold pre-refinement)**
    - For oil, this isn't an issue – oil that comes out can be marketed and sold in that State (same as what comes out of the wellhead)
    - For gas though, it's common for NG production to mixed sweet/sour… → more costly
    - Why is current market value used instead of the selling price (the price that the lessee sells to the refinery)?
      - Oftentimes the lessee will own the refinery that they are selling the oil to, and therefore the selling price would be too low.
  - **What if the well produces both sour/sweet gas? (the Jumping Pound Formula)**
    - More complex because gas generally must go through more refining with costs prior to sale
    - Gas usually must be upgraded before it can go to market
    - So there is different formula for determining wellhead price of gas as compared to oil
    - **Jumping pound formula:**
      - Before the royalty is paid to the lessor of NG, take the tail gate price (the price of the gas at the processing plant) and subtract proportionate costs of transportation and processing. Also account for the rate of return on the investment in the processing and transportation system.
  - **Bishop Lease (Clause 2); CAPL99 (Clause 4)**

Anatomy of the PNG Lease – Summary

- **1) The Granting Clause**
- **2) Habendum Clause**
- **Habendum Provisos: Delay Rental; Dry Well Clause; Continuous Operations/Development Clause**

- **3) The Shut-in Well Clause**
- **4) The Offset Well Clause**
- **5) The Pooling Clause**
- **6) The Default Clause**
- **7) The Manner of Payment Clause**

1. The Delay Rental Clause

Paddon Hughes Development Co v Pan Continental Oil Ltd **(1998 ABCA) – Delayed Rental Payments Sent by Mail; Date Sent was Before Date Due, So Within the Prescribed Time in Lease**

- **Facts**
  - Pancontinental (P) was the current lessee of two pooled leases owned by Thatcher and Bishop. Paddon Hughes (PH) was the top lease holder, and would have received the leases if they lapsed with P. The main problem is the date that a delay rental payment is considered received. The one year anniversary of the leases required payment by August 17 and 20th respectively, if no production was occurring (P was required by the lease to start drilling or pay the delay rental payment each year). Neither lease was producing. Pancontinental claims that the cheques were mailed in the prescribed form on August 9, but the TD bank did not issue a notice of receipt until August 26 and September 4, respectively for the payments.
  - Note that delay rental payment must be received by the annual anniversary of the creation of the lease (prior to midnight of the day preceding the anniversary day)
  - Trial judge found that the delay rental payments were made within the times prescribed by the leases.
- **Issue**
  - Were the delayed rental payments made within the one year time period to continue the lease?
- **Analysis**
  - Finding of fact was that the payments were mailed prior to their due dates on Aug 9th
  - The Bishop lease specified that mail was an appropriate method of payment, implying that payments are considered received when they are mailed (i.e. Aug 9th) which occurred prior to the 1 year period (the lease is valid).
  - The Thatcher lease did not specify when payment would be considered received or the method.
    - While the lease did not specify whether payment could be received by mail, it did provide a clause that payment "should be received at X address"
    - Commercial reality and the fact that the address was a postal address suggested that mailing was appropriate for making payments
      - **Court looked to the industry practices in the commercial reality**
    - The clause interpreted by the court as indicating that the mail payment was effected by the **date of mailing**
    - Pancontinental had done what was required of it under Clause 21, namely pay the delay rental to Thatcher at the address specified
- **Holding**
  - Appeal dismissed; date of mailing the payments was before the due date, so delayed rental payments were made within the time prescribed by the leases
- **Dissent**
  - Mailing a payment was differentiated from the typical postal rule of offer and acceptance. The Thatcher lease was silent and other jurisprudence indicates that a payment is not made until it is received.
  - Normally can accept by post on the day that the acceptance is placed in the mail, but it does not work the same way for payment by mail
- **Ratio**
  - Even where mailing is not expressly stipulated in lease, if it accords with parties' business intentions and language of the lease, mailing of delay rental payment before anniversary date constitutes timely payment
- **Notes**
  - **Facts**
    - Bishop (Aug. 17) v Thatcher (Aug. 24) leases (pp 168-169)
  - **Issue**
    - Was the delay rental payment made on time to extend leases beyond their first anniversary?
  - **Holding**
    - Clause 22 of the Bishop Lease looks different than Clause 24 of the Thatcher Lease
      - Bishop – When in mailbox, it's deemed to be received
        - Para 22 – All payments to the Lessor provided for in this Lease shall, at the Lessee's option, be paid or tendered either to the Lessor or to the depository named in or pursuant to this clause, and all such payments or tenders may be made by cheque or draft of the Lessee either mailed or delivered to the Lessor or to said depository, which cheque or draft shall be payable in Canadian funds at par in the bank on which it is

drawn. In the case of payments which are mailed, such payments shall be deemed to be received by the Lessor as of the date of mailing

- Thatcher – All payments to the Lessor provided for in this Lease shall be paid to the Lessor at the address specified in Para 24
  - Para 24 – All notices to be given hereunder may be given by registered letter addressed to ... the Lessor at San Francisco, California, U.S.A. 94110 507 Peralta Avenue. or such other address as the Lessor ... may ... from time to time appoint in writing, and any such notice shall be deemed to be given to and received by the addressee seven (7) days after the mailing thereof, postage prepaid

- End up looking purposively at what the parties provided
  - Address provided was a postal address - common in these scenarios that the postal address is used (commercial release)
- Payments mailed on Aug. 9
- Trial – Permissible under the Bishop lease; construed as being permissible under the Thatcher lease (p 170)

- **Appeal**
  - Confirms the trial court's decision for the Bishop lease
  - Thatcher lease presents an interpretative question (p 170)
    - Address provided is a mailing address
    - "Commercial reality" – makes these things appropriate
    - Did it have to be "delivered" at/before the anniversary date or was it sufficient to have been mailed before the date?
      - Sufficient to have been mailed before that date
- Dissent – *under ordinary contract law mailing is not payment (this is different than offer/acceptance rules)*
- You end up with a majority that construes offer/acceptance more broadly

2. The Habendum and Continuous Operations Clause

Canadian Superior Oil Ltd v Crozet Exploration Ltd (1982 ABQB) – CSO Lease Valid and Subsisting by Habendum Clause Allowing Extension By Operations In Primary Term; Test for Operations (Preparatory Steps Sufficient); Purposive Interpretation

- **Facts**
  - PNG lease entered into by Canadian Superior (CSO) (D) on July 31, 1975. Primary term was to expire at midnight on July 30, 1980. Crozet (P) had a toplease.
  - On June 4, 1980, CSO granted an option to drill on the leased lands to Surf (not a farm-out because Surf wanted to learn the results of drilling operations on adjacent lands - section 6 in the same township - in which it had an interest).
  - Surf exercised that option on July 22, 1980.
  - Surface lease obtained on July 23, 1980.
  - July 24th survey of the access road and well site was completed and the responsible contractor started constructing the access road. The combination of substantial rains and a sloped site required Surf to bring in gravel to stabilize and level the site. This was completed on July 28, 1980.
  - Sump pits, rat hole, and mouse hole were drilled on July 27.
  - On July 30 the dismantled rig moved on site ready to be hoisted vertically.
  - July 30 "rigging up" commenced. Well license issued on July 30.
  - Derrick raised to vertical position on July 31 and well spudded in on July 31 (surface of the ground was broken by the rotating action of the drill bit)
    - Well started producing and continues to produce at the time of litigation.
  - Habendum clause allowed the primary term to be continued as long as operations, as hereinafter defined, are conducted on the said lands
    - Key point: Primary term + operations (not production)
    - **Operations shall mean:** drilling, testing, completing, reworking, recompleting, deepening, plugging back or repairing of a well in search of or in an endeavour to obtain or increase production of the leased substances or any of them, excavating a mine, production of the leased substances or any of them (whether or not in paying quantities), or operations for or incidental to any of the foregoing.
- **Issue**
  - Was the lessee conducting "operations" at the end of the primary term (midnight on July 30)?
- **Analysis**
  - Drilling is not required. Preliminary acts were conducted with a bona fide intention to proceed with diligence to completion; Short periods of inactivity or delay may be accepted as being in accordance with good oil field practice.
  - **Test for drilling/spudding in:**
    - Actual ground has been broken

        - *If this had been the test, it would've failed*
    - **<u>Test for "operations for or incidental to [drilling]":</u>**
        - (1) Good faith preparatory steps with the intention of completing the well,
        - (2) Preparatory steps must be taken with reasonable diligence and dispatch tested by the principles of good oil field practice,
        - (3) Preparatory steps must not simply be minimal
    - **Application to the facts:**
        - Actual spudding was not required because the habendum clause allowed for operations to extend the primary term
        - The activities taken by the lessee were in good faith intention to drilling a well for production
        - The lessee was taking reasonable steps and showing expected dispatch as would be norm in the industry
        - The steps taken were more than minimal (Here: Everything but spudding/drilling)
    - **NOTE:** A harsh interpretation of the lease would have deemed the lease to be dead. This was another flexible approach like *Cull*.
        - These two cases are the beginnings of a more purposive approach to the lease.
        - The Court here refers to *Cull* and accepts the proposition that there is a "liberalization" of the absolute strictness of interpreting leases.
- **Holding**
    - The lessee was conducting operations at midnight on July 30, and therefore their lease is valid and subsisting.
    - **Lessee:** The general rule seems to be that actual drilling is unnecessary, but that the location of wells, hauling lumber on the premises, erection of derricks, providing a water supply, moving machinery on the premises and similar acts preliminary to the beginning of the actual work of drilling, <u>when performed with a *bona fide* intention to proceed thereafter with diligence toward completion of the well, constitute a commencement of well or drilling operations within the meaning of this clause of the lease (from an American text)</u>
    - **Lessor:** Operations for or incidental to drilling do not include work preparatory to drilling, and that spudding must be done prior to the expiry of the primary term for there to have been sufficient "operations" to continue the lease
- **Ratio**
    - Lease set to expire may be valid and continued (despite precise terms of contract not being fulfilled) if sufficient preparatory steps taken to begin "operations" as permitted in the habendum clause as long as:
        - (1) Preparatory steps must be taken in good faith with the intention of completing the well,
        - (2) Preparatory steps must be taken with reasonable diligence and dispatch tested by the principles of good oil field practice,
        - (3) Preparatory steps must not simply be minimal
- **Notes**
    - **Facts**
        - An attack on a lease by the top lease holder
        - Habendum (p 174)
            - TO BE HELD BY the Lessee, unless sooner terminated or longer kept in force under other provisions hereof, for the term of Five (5) years from the date hereof, the said term being hereinafter called "the primary term", and so long thereafter as operations, as hereinafter defined, are conducted upon the said lands or the pooled lands with no cessation for more than ninety (90) consecutive days. Whenever used in this Lease, the word "operations" shall mean any of the following: drilling, testing, completing, reworking, recompleting, deepening, plugging back or repairing of a well in search for or in an endeavor to obtain or increase production of the leased substances or any of them, excavating a mine, production of the leased substances or any of them (whether or not in paying quantities), or operations for or incidental to any of the foregoing.
                - At the end of the primary term, in order to succeed, you need production or operations (includes activities that are incidental… → Favors the lessee)
        - Timeline for well drilling (p 174) + intention (p 176)
            - Did they achieve production within the primary term? No
            - Did they commence drilling (break ground)? No, it's not until July 31 at 9PM
            - Did what they do satisfy the operations clause?
    - Issue
        - Was the primary term extended? "Operations for or incidental to [drilling]" occurring at the material time?
    - Court:
        - Yes, this was sufficient to satisfy the habendum (given the unique language)
            - They didn't get the license to drill until July 30; they had erected the drilling apparatus, it just hadn't been turned on

Canada-Cities Service Petroleum v Kininmonth **(1963 ABSC; 1964 SCC) – Habendum Clause Trumps the Continuous Operations Proviso; Production was Needed to Extend Lease Past First Term; Habendum/Proviso Separated What was Aid in One Clause in *Crozet***

- **Facts**
  - OilCo (lessee and appellant) obtained a 10 year lease from Kininmonth (lessor) on May 11, 1951 to drill an oil well. The lessee must begin production before the end of the 10 year term (May 10, 1961).
  - OilCo availed itself of the right to postpone from year to year its drilling commitment by paying the delay rentals.
  - OilCo drilled a well in March, 1961 and found oil in the Cardium sand formation. At the time, the ERCB had specified a special spacing unit for the Cardium area of ½ section (being either the east or west section). OilCo's lease only covered the south half of the section.
    - ERCB says that lessee has to cap their well and cannot produce until the proper half section is acquired.
  - OilCo wanted to bring the producing well equipment on site, but there was a road ban in effect, and the well did not produce until June 26, 1961.
    - ERCB immediately ordered OilCo to cease production because it had not acquired the prescribed spacing unit
  - Caveat had been filed by the appellant to protect its interest under the lease.
  - Respondents gave the form of notice prescribed in that Act, whereby the caveat ceases to have effect after the expiration of 60 days next ensuing the date of the notice, unless proceedings are commenced by the caveator on the caveat.
  - The appellant (OilCo) commenced this action, seeking a declaration that the lease was valid and subsisting
- **Issue**
  - Although production had not occurred by the 10 year anniversary, could this lease be saved by the fact that the OilCo had commenced operations before the 10 year term which eventually led to successful production?
- **ABCA**
  - Majority: No, the lease terminated; The road ban was not "sufficiently outside" the control of the lessor to evoke the continuous operations clause. Road closures are reasonably foreseeable as they happen every spring; the operator could also have applied for a variance of the ban (**note:** the onus is on the operator to show that something occurred that was beyond their control, and that why they could not achieve production in the primary term)
    - ABCA did not take the same approach as the SCC though: for the ABCA, the continuous operations clause to term would have effectively extended the lease if there had been an occurrence that was sufficiently outside the control of the lessor
  - Dissent (MacDonald): The lease allows an appellant, so long as they do so in good faith, to take to completion a well that has been commenced inside the primary term, and production from this well would continue this lease.
    - Felt that the suspension of drilling by the board (as the lessee did not have proper SU's) was outside the lessee's control and was required to be obeyed, allowing the continuous operations clause to continue the lease.
- **Analysis**
  - **NOTE**: the habendum clause is different here than the one in ***Crozet***; it does not say that operations will extend the lease, only **production** will extend the lease to a second term
  - **Clauses in the Lease:**
    - **Habendum clause:** "To have and enjoy the same for a term of 10 years from the date hereof, and so long thereafter as the said substances or any of them are being produced from the said lands, subject to the sooner termination of the said term as hereinafter provided."
    - **Proviso 3 – Continuous Operations Clause:** "if **at any time after** the expiration of the said 10 year term the said substances are not being produced on the said lands and the lessee is then engaged in drilling or working operations thereon, this lease shall remain in force so long as such operations are prosecuted, and if they result in the production of the said substances or any of them, **so long thereafter** as the said substances or any of them are produced from the said lands, provided that if drilling, working or productions are interrupted or suspended as the result of any cause whatsoever beyond the lessee's control, other than the lessee's lack of funds, the time of such interruption or suspension shall not be counted against the lessee, anything hereinbefore contained or implied to the contrary notwithstanding."
  - **SCC:** The **proviso 3 continuous operations** clause is designed to deal with the situation where the primary term has been extended by production and such production ceases outside the primary term;
    - Proviso 3 will only come into effect when the lease has been continued by production and then production has ceased (in cases such as the reservoir being drained)
    - Without this clause, the lease would automatically terminate upon cessation of production. This clause allows the leases to be continued provided that the lessee is continuing operations on the said lands.
  - **Martland's Interpretation of the habendum clause:** He treats it as a condition precedent to the extension of the lease beyond the 10 year term: there must have been some production to extend the lease
  - **Interpretation of the continuous operation clause:**

        - "I cannot construe the paragraph as meaning that, even though no production has been obtained within the 10-year primary term, the lessee may thereafter carry on drilling operations on the land which, if successful, will then serve to extend the lease for a further period during the continuance of such production.
        - The latter part of [the continuous operations clause] <u>covers the situation which may occur if drilling, working or production operations are interrupted or suspended by causes beyond the lessee's control.</u>
            - In my opinion this clause only comes into effect if the lease has already been extended beyond the 10-year primary term, as a result of production, and then such production ceases."
    - **Outcome for the future:**
        - Leases now clarify the continuing operations clause or to bullet proof the lease, the "operations" allowance to extend a lease should be included in the habendum clause, and not just in a separate proviso
- **Holding**
    - Appeal dismissed. The paramount term in the lease is the habendum: "So long thereafter as there is production" requires production during the primary term. The lease dies on May 10 and Proviso 3 (continuous operations clause) does not resurrect the lease; court interprets the lease by way of strict construction
- **Ratio**
    - A habendum clause that specifies production must occur in primary term to extend the lease trumps a continuous operations clause that states that the lease will be extended if operations are paused for a reason outside of the lessee's control (SCC says proviso is not activated until production on the lease has in fact begun)
- **Notes**
    - **Facts**
        - Lease – May 11, 1951
        - Primary term – 10 years
        - What's needed to extend primary term into the secondary term?
            - Habendum - To Have and Enjoy the same for the term of 10 years from the date hereof, and so long thereafter as the said substances or any of them are being produced from the said lands, subject to the sooner termination of the said term as hereinafter provided.
                - Production → Not achieved here. You have the well which was drilled in time, but actual production doesn't happen until after the primary term expires
                - Proviso 3 → Becomes the importance clause here
                    - And Further Always Provided that if at any time after the expiration of the said 10 year term the said substances are not being produced on the said lands and the Lessee is then engaged in drilling or working operations thereon, this Lease shall remain in force so long as such operations are prosecuted, and if they result in the production of the said substances or any of them, so long thereafter as the said substances or any of them are produced from the said lands…
                        - Lessee – this language should save us (*this fails*)
            - Here, the lease has been caveated, however this is being challenged – lessee must prove it is valid
    - **Issues**
        - Well is drilled in time but not brought into actual production until <u>after</u> the primary term expires
        - Habendum + Proviso 3
        - No production at the end of primary term, but operations. Sufficient?
        - Proceedings brought to validate the caveat (which would expire in 60 days without action) (p 180)
    - Lease upheld at trial; reversed on appeal
    - At ABCA, focused on reasons for interruption
        - Majority – Smith J
            - Burden re: factors beyond the lessee's control?
            - Road ban?
            - Court: This is not great justification as a disruption
            - Focused decision on production/primary term with an expectation of diligence and dispatch
            - This is not like the *Crozet* case – the habendum here is restricted and not saved by proviso 3
        - Dissent – MacDonald J
    - **Kininmonth fatal gap problem:**
        - Production required as a condition precedent prior to operations clause in a proviso taking effect (*at* v. *after*)
            - Bishop vs Kininmonth lease language
                - Bishop – "If at the end…" → allows for drilling/operations to continue lease at critical juncture
                - Kininmonth – Here, the lease only contemplates sometime **after** the expiration of the primary term – need a scenario where there's disruption.
                    - It doesn't allow for operations at the critical juncture
        - Generally, lease requirements to be strictly construed

        - Consequences?
    - Martland J
        - No production at material time (lease clauses construed at p. 180)
        - Fifth paragraph deals with the situation where it the primary term has *already been extended*
        - Habendum NOT extended/modified by this language
        - Dismisses outlying American precedent that gives the lessee the right to complete an initiated well (Oklahoma)
        - Strict construction that focuses on the lease at hand

Sohio Petroleum Co v Weyburn Security Co **(1971 SCC) – Lease Expired Just Like in *Kininmonth*; Estoppel Not Valid Due to Parties Just Conducting Normal Business Under Mistaken Belief; Lessee Keeps Profits Up Until the Point the Action was Started (Subconscious Unjust Enrichment)**

- **Facts**
    - Sohio (appellant, lessee) began to drill a well 1 week before the expiration of the primary term of their lease, and completed the well after the expiry of the primary term (simple ***Kininmonth*** problem).
    - Sohio felt that because of their amended continuous operations clause ("COC"), the lease would not have expired.
        - However, their COC almost restated the COC in ***Kininmonth*** – the clause required that there already be production at the end of the primary term.
        - Here there was no production until after the expiration of the primary term, and therefore, the lease expired on the 10 year anniversary.
    - 7 years went by before anyone knew there was a problem
    - Sohio argued that **promissory estoppel (i.e. that the lessor is estopped from denying the validity of the lease)** on four grounds:
        - (1) Weyburn (lessor) called Sohio to drill an offset well,
        - (2) Sohio, at the request of Weyburn, paid a portion of the mineral taxes,
        - (3) Sohio paid and Weyburn accepted royalties,
        - (4) Weyburn permitted Sohio to enter into a pooling agreement
    - Court found that the lease had expired after 10 years, following ***Kininmonth***
        - Weyburn sued for the proceeds that were received over the years of production from the well; Sohio counter argues promissory estoppel and subconsciously argues unjust enrichment.
- **Issue**
    - Are there grounds for a promissory estoppel argument? How does the court provide justice to the parties?
- **Analysis**
    - **Estoppel**
        - **Estoppel** – party is stopped from enforcing their rights where they give an unequivocal representation that they will not hold the other party to strict enforcement of their rights
            - Can be by acquiescence or can be promissory
        - **The lessor is NOT estopped from denying validity of the lease for the same three reasons in *Paddon-Hughes*:**
            - <u>(1) No unequivocal representation by the lessor</u>—in order to assert your strict legal rights you need to know you have them. The lessor did not know they had right to declare lease invalid for some time.
                - Both parties were operating under the mistaken belief that the lease was still valid
                - So, to argue estoppel: Would have to point to evidence that Weyburn knew that the lease could be declared to invalid
            - <u>(2) The lessee did not act on the lessor's representation</u> – Sohio was not relying on what the farmer said to its detriment, but rather it was relying on their own legal team. Did not act on representations but rather their own judgment.
                - These 2 factors will bar most cases
            - <u>(3) Estoppel requires an existing legal relationship</u> and cannot revive a dead lease. Representations were made long after the lease had expired.
    - **"Subconscious" Unjust Enrichment**
        - Decision happens 12 years after the lease expired. What happens to the production that Sohio acquired during this time?
        - Weyburn says they should keep all proceeds as Sohio was a trespasser. Argument against this is UE.
        - The solution here was for the lessee (Sohio) to keep all of the proceeds up until the point that the action was started. After that, the lessor will receive the proceeds.
            - The lessee spent money in producing the oil, so it would be unfair to not give them some of the profits so as to cover their costs.
            - Net proceeds of production—revenues minus costs of production.
            - Sohio was an innocent/unofficious trespasser—they were not being malicious but there by mistake
        - **Why is the calculation done on the date of the writ of summons – commencement of action?**

                - Lessor had a royalty agreement. An accounting from the date the lease terminated would give the lessor more than they had bargained for or would have bargained for in a new lease.
        - **Unofficious/Innocent trespasser**—can recover costs of production (sunk costs)
            - **Incontrovertible benefit**: As an owner of a mineral estate, the lessor would have inevitably produced the minerals, as such, the lessor cannot argue that he would not have drilled the well, so the drilled well is an incontrovertible benefit
                - (1) Deprivation: S built the producing well
                - (2) Corresponding enrichment: W was enriched because they have been producing well on their lands
                - (3) Absence of juristic reason: As soon as the lease expired there was no longer a juristic reason for the enrichment (i.e. S would not have drilled the well if they would have known that the lease was expired)
        - **Officious trespasser**— would not get any of the proceeds because they knew the lease was invalid.
            - In effect this is a punitive measure, you must give up everything which seems dedicated to punishing the wrongdoer
        - Every one of these cases has the potential for UE, but this is the first time that it was raised, albeit "subconsciously".
- **Holding**
    - There were no grounds for promissory estoppel to be relied upon by the lessee. Justice was granted in the form of unjust enrichment (solution here was for the lessee Sohio to keep all of the proceeds up until the point that the action was started by the lessor; after that, the lessor will receive the proceeds) – this was a subconscious application of unjust enrichment
- **Ratio**
    - Estoppel by words and conduct cannot operate where both parties are under mistaken belief that the lease was valid and continuing and no representation was relied upon
- **Notes**
    - Facts: Lease expiry for the same reason as ***Kininmonth***
    - Issues
        - Can an expired lease be subsequently enforced based on words and conduct of the lessor?
        - Can a party be estopped from denying lease validity because of words & representations?
        - Here, simply performing contractual obligations that they were otherwise obliged to do, under a (mutual) mistaken fact (p. 183-184)
        - These were things expected to be undertaken under the lease
    - Court
        - All that's happening here is the parties are operating under a mistaken belief – they were acting as if it were valid
        - There was nothing novel; this was stuff that was done under normal business under mistaken belief
        - Thus, estoppel doesn't work (Note: *Estoppel won't work in any cases, and UE will work in very few cases*)

Cull v Canadian Superior Oil Ltd (1972 SCC) - COC Extends Lease Until Production Occurs Even When Drilling Already Done; Acted with Reasonable Diligence and Dispatch to Bring the Well into Production; Proper Clauses with Unique Language to Fix *Kininmonth* Problem

- **Facts**
    - Lease expired on December 30. CSO (respondent) commenced drilling the well on December 28. On December 30 they moved the drilling rig off the well site, brought in a service rig on January 2nd, and the well was capable of production on January 7th; actual production began on January 13th. There was a brief period where there was no drilling and no production.
    - The appellant, Cull, gave notice requiring removal of CSO's caveat on the leased lands; CSO brought this action seeking a declaration that the lease was good, valid and subsisting, not expired
    - **Habendum Clause:** This lease shall be for a term of 10 years and so long thereafter as oil, gas or other mineral is produced from the said land hereunder, or as long thereafter as the lessee shall conduct drilling, mining, or reworking operations thereon as hereinafter provided and during the production of oil, gas or other mineral resulting therefrom.
    - **Continuous Operations Clause (clause 12):** "If the lessee shall commence to drill a well within the term of this lease or any extension thereof, the lessee shall have the right to drill such well to completion with reasonable diligence and dispatch, and if oil or gas be found in paying quantities, this lease shall continue and be in force with like effect as if such well had been completed within the term of years herein first mentioned."
    - **Lessor's (appellant) Argument:** The continuous operations clause only extended the lease until completion of the well. It could only be continued thereafter if production was being obtained from the leased lands, and there was no production until 6 days after the well was completed. The well was completed on December 28th, so the continuous operations clause was not in effect. No production occurred before the expiry of the term. Therefore, we have a "fatal gap" in production, same as the lease in *Hambly*.
    - **Trial Judge**: Held that the well had not been drilled "to completion" when the primary term expired, and that clause 12 gave the respondent the right, after such expiration, to continue to drill to completion; the lease was valid and subsisting

- **Issue**
  - Subsisting lease because of clause 12 or expiry because of no production under habendum?
- **Analysis**
  - **The lease in *Hambly* contained a provision similar to this one, but is distinguishable**
    - The lessee in ***Hambly*** commenced to drill a well shortly before the expiration of the primary term, which was completed thereafter.
    - It was a gas well and there was, at that time, no available market for gas produced from it. It was not intended to be put into production nor was it put into production. No bona fide intention was present to bring the well into production.
  - Here, the actions of the lessee kept the lease alive because they drilled a producing well on the 28th and brought it into production with reasonable diligence and dispatch
    - The continuing operation clause indicated that the lessee had the right to drill to completion with reasonable diligence and dispatch, but did not say anything about necessarily bringing the well into "production" to extend the primary term of the lease
  - **The court found that not only can you drill with reasonable diligence and dispatch, but that *you can bring the well into production with reasonable diligence and dispatch***
    - Court said we will allow this to count as production as long as lessee takes reasonable and favorable steps to bring the well into production, in which case the production gap does not matter.
    - Therefore, the lease is extended if you acted with reasonable diligence and dispatch to bring the well into production
    - There was a bona fide intention to proceed diligently to place the well on production **and this intention was effectuated with reasonable diligence and dispatch**, and the well commenced to produce on 13th January
  - **Key Point:** This case turns on actual (*Cull*) vs. deemed production (*Hambly*)
    - A lease with a *capped well* can only be kept alive by paying the SIR before the end of the primary term, whereas a lease with a *producing well* can be kept alive by bringing that well into production with reasonable diligence and dispatch.
- **Holding**
  - Appeal dismissed; the lease is valid and subsisting
- **Ratio**
  - Must consider clauses in conjunction with each other. For this type of clause, it is sufficient if following completion of the well, production is obtained with reasonable diligence and dispatch
- **Note**
  - ***Cull* gap scenario:**
    - Gap between the completion of drilling and production; however, cured by unique operations clause which is given a purposive interpretation
      - Unique language that rectifies a scenario that would otherwise lead to termination
  - Many people regard this as a watershed case in O&G law. It is the end of purely technical interpretation. Every other case up until this point just looked at the words of the lease. In this case they looked at the practical reality, which, based on the words of the lease would lead to an absurd result
  - Facts
    - Lease at p. 185
      - Lessor – Cull; Lessee - CSO
      - Lease signed December 30, 1974; 10-year primary term
      - Habendum – Subject to the other provisions herein contained this lease shall be for a term of 10 years from this date (called "primary term") and as long thereafter as oil, gas or other mineral is produced from the said land hereunder, or as long thereafter as Lessee shall conduct drilling, mining or reworking operations thereon as hereinafter provided and during the production of oil, gas or other mineral resulting therefrom."
    - Unique clause 12 (modifies a usual Proviso 3) – If Lessee shall commence to drill a well within the term of this lease or any extension thereof, Lessee shall have the right to drill such well to completion with reasonable diligence and dispatch, and if oil or gas be found in paying quantities, this lease shall continue and be in force with like effect as if such well had been completed within the term of years herein first mentioned.
      - Reads like a modified Proviso 3
    - Here, there is a gap – no production was achieved; however, there were additional steps that were taken
  - Issue
    - Subsisting lease or expiry because of no production?
    - Caveat in action – p. 186
    - At trial, lease expired because the well drilling stopped on January 7 and production didn't begin until January 13th; estopped in asserting lease termination, however, because of amending agreement
      - Successful estoppel claim at the trial level
    - On appeal, case turns on unique language (of clause 12) and ability to achieve production w/ reasonable diligence and dispatch – p. 187
      - Similar language to ***Crozet***
  - Court

- Clause 12 isn't amending the habendum, but gives context to understand the habendum
- You don't need production the moment the operation ceased, because they were carrying out what was necessary to get the well ready for production and drive this forward
- This unique language takes you out of the ***Kininmonth*** scenario

Canadian Superior Oil Ltd v Murdoch (1969 ABSC; 1969 SCC) – COC Identical to *Kininmonth*; Lease Expired Because No Production Occurred and No Deemed Production Since Gap in SIR Payment, But There was No Intervening Top Lease; 2nd Agreement Between Parties Resolved *Kininmonth* Problem; Lease Now Valid

- **Facts**
  - Ms. Murdoch granted a 10-year lease to CSO on April 22, 1950. Primary term of lease expired at midnight on April 21, 1960. The lessee farmed out the job of drilling the well to Amax, who drilled on March 12, 1960 and finished on April 20, 1960. The well was brought into production after the lease expired. Lessee promptly says to ERCB that they would like to shut in the well. This is granted on May 6, 1960, and the lessee sends a SIR (shut in royalty) cheque to the lessor on May 16, 1960. Actual production commenced afterwards. The lease was dead because there was no actual production, and no deemed production (because deemed production can only occur on the date of the payment of the SIR, which in this case was after the expiration date of the lease). (phase 1)
  - A year later another Oil Co looks at the lease and determines that CSO did not have the required authorizations to get the lease as Mr. Murdoch had an interest in the land. CSO had leased lands from Mrs. Murdoch and was unaware that Mr. Murdoch actually owned a portion. CSO files a caveat. Mr. Murdoch seeks an action to remove the caveat. CSO enters into a settlement agreement that indicated the old lease was still alive and valid. They paid both Mr. & Ms. Murdoch money and the Murdoch's, in return, ratified the lease. (phase 2)
  - Ms. Murdoch gets sick of dealing with Canadian Superior, and makes a claim in 1961 that the entire original lease was invalid because at the end of the primary term there was no production. (phase 3)
  - Trial judge held that that the lease was valid and subsisting on the basis of the agreement under phase 2
    - Ms. Murdoch was estopped from denying the validity of the petroleum and natural gas lease she had signed
    - Estoppel by words/conduct
  - Court of Appeal - there are several possible interpretations
    - Instead of estoppel, re-granting of the interests under lease (American cases)
    - Extinguishment of any claim Murdoch's would have against Canadian Superior challenging validity of lease
    - Instead, just look at nature of K the parties agreed to
      - We don't have to look beyond the agreement itself
      - Canadian Superior got recognition that lease was in good standing
      - So don't have to rely on estoppel or extinguishment of claim – just basic contract principles (what was the K trying to achieve?)
      - Lease termination had occurred but then parties turned their minds to desired outcome of lease moving forward by rectifying issues
- **Issue**
  - Deemed production did not result until May 16, 1960, which is after the expiration of the primary term, however, is this lease nonetheless valid as a result of the second contract between the parties?
- **Analysis**
  - **Phase 1 -** The original lease expired on April 21, 1960 as there was no actual or deemed production as required by the habendum clause. Based on this, the lease is invalid.
  - **Phase 2** - However, the lease was extended by the contract (a subsequent agreement) entered into between the parties. They weren't bettering their position, they simply agreed that lease was valid in exchange for good consideration.
    - Vital point—**unlike other cases, there was no intervening top lease**
  - **Phase 3 -** Lower courts decided this case on the basis of estoppel, SCC says that this is not an estoppel case, Mrs. Murdoch simply cannot get out of the lease because she contracted away her ability to do so.
  - **Key Points:**
    - 1) A lease can be extended by deemed production, but this requires a shut-in royalty (SIR) to be paid in a timely manner so that there is no gap in time where there is neither deemed nor actual production.
      - Here, the well was completed within the primary term, but the cheque was paid afterwards.
      - This means that there was no production and no deemed production for a certain window of time.
    - 2) Parties can repair a defect in a lease (not through estoppel) through a normal contract
- **Holding**
  - Yes; Appeal dismissed, the lease is valid and subsisting because of the agreement between the parties that the lease would continue, for valid consideration that was provided (so, there was an agreement between the parties and no reliance on promissory estoppel was necessary to resolve the problem)
- **Ratio**
  - Lease can be extended by contractual agreement between the parties after the lease expires
- **Note**
  - ***Murdoch*** problem:

        - Gap in SIR payment (cured by subsequent contract)
        - Generally, if you want to extend a primary term into the secondary term by constructive (deemed) production, SIR must be paid *before* the primary term ends or, minimally, *before* any gap arises
    - On ***Cull*** (more flexible approach to the O/G lease)
        - Production was not achieved by the anniversary date, but construction of the well was complete, and you could not bring the well into commercial production therefore the lease will be extended if you bring it into production using reasonable diligence and dispatch
    - Facts
        - And Further Always Provided that if at any time after the expiration of the said Ten (10) year term the leased substances are not being produced on the said lands and the Lessee is then engaged in drilling or working operations thereon, this lease shall remain in force so long as such operations are prosecuted and, if they result in the production of the leased substances or any of them, so long thereafter as the leased substances or any of them are produced from the said lands
        - Under heading of "gas wells"
            - Provided no royalties are otherwise being paid hereunder, the Lessee shall pay to the Lessor the sum of One Hundred ($100.00) Dollars each year as royalty on each gas well where gas only or primarily is found and the same is not used or sold and while the said royalty is so paid such well shall be deemed to be a producing well hereunder and to be producing leased substances from the said lands.
        - SIR cheque was sent to appellant on May 16 (~3 week gap between end of lease and receipt of SIR payment)
        - Also issue that another part of land weren't actually in the lease arrangement
        - Lessee's argument
            - We had a MOA that should've fixed these issues
                - 3. A dispute developed between the parties hereto as to whether the said lands were subject to the said Lease and that the said dispute became the subject of Supreme Court Action No. 65113 in the Trial Division of The Supreme Court of Alberta, Judicial District of Calgary.
                    - Seems to contemplate a dispute between the parties
                - The parties agree to
                    - 1. Canadian Superior shall pay to William G. Murdoch the sum of $14,000.00 and in consideration therefor, William G. Murdoch shall:
                        - (a) give to Canadian Superior a lease of petroleum, natural gas and related hydrocarbons, within, upon or under the said lands, reserving a gross royalty of 12½% thereon to himself; (b) provide a release of the beneficiary or beneficiaries of John Brown, deceased, as to any interest in the said lands; (c) discontinue Supreme Court Action 65113; (d) execute the Crossfield Turner Valley agreement.
                    - 2. Canadian Superior shall pay to Agnes Murdoch the sum of $500.00 and in consideration therefor, Agnes Murdoch shall: (a) discontinue Supreme Court Action 65999; (b) execute the Crossfield Turner Valley Unit Agreement.
                    - 3. Subject to the payment of the amount set forth in Clause 3 hereof, Agnes Murdoch, for herself, her heirs, executors, administrators and assigns does hereby ratify and confirm that the said Lease is in good standing and of full force and effect.
    - Issue**:**
        - Subsisting lease or expired lease?
        - Operator concedes that production didn't occur and that they failed to make timely SIR payment (p. 190)
        - Murdoch sought removal of caveat from title and injunction preventing the registration of a further caveat
        - Lessee points to the Memorandum of Agreement (Feb. 1962)
    - Reasoning
        - Effect of covenant (Estoppel – approach at trial? Re-grant – lessee's argument? Extinguishment of claim?) (p. 190)
            - Trial
                - This agreements acts to estop the lessors from denying lease validity
                - The lessee says that this is a re-grant (a new instrument that will free of the default flaws in the first)
                - This simply operates to extinguish the claim the Murdoch's had
        - CA: End up focusing on the curative ability of subsequent contracting between the parties
        - SCC confirms the reasoning
        - *Resolved as a contract*: no mistake; no misrepresentation; valid consideration given and claim extinguished

Canadian Superior Oil v Paddon-Hughes/Hambly **(1969 ABSC; 1970 SCC) – Similar Language to *Cull* Allowing Extension If Reasonable Diligence and Dispatch Taken, Except Here There was a Gap Between Completion and Shut-In Payment to Deem Production; Lease Not Extended; Estoppel Claim Fails**

- **Facts**
  - A lease with a primary term of 10 years was entered into on June 17, 1948. The lessee created a farm-out agreement which was executed on June 5, 1958. The farmee commenced drilling on June 10, 1958. Well was finished on August 8, 1958.
  - On August 9, 1958 drilling production ceases, the lessee suspends the well and makes an application to shut it in, makes a SIR (shut in royalty) payment that is received on August 14, 1958. Why is the lease invalid?
    - Note the fatal 5-day gap where there is not drilling operations or production/deemed production
  - Lessee made SIR payments to the lessor for 7 years and raises the estoppel argument on the grounds that the lessor had accepted SIR payments for 7 years and had called upon the lessee to repair the well on several occasions.
  - CSO had been alive to the ***Kininmonth*** problem, and had attempted to amend the problem with the old continuous operations clauses by inserting clause 12, which says that:
    - "If the lessee shall commence to drill a well within the term of this lease or any extension thereof, lessee shall have the right to drill such well to completion with reasonable diligence and dispatch, and if oil or gas be found in paying quantities, this lease shall continue and be in force with like effect as if such well had been completed within the term of years herein first mentioned."
      - Effectively, the lessee shall commence drilling sometime during the term, but shall have the right to complete the well outside the primary term using reasonable dispatch.
  - Action was commenced pursuant to a notice given under The Land Titles Act, RSA, 1955, ch. 170, requiring the lessee to commence proceedings to substantiate their right to maintain their caveat on the title to the section of Hambly's lands
  - Alberta Supreme Court
    - Appeal dismissed; there was binding authority to the effect that shut-in royalties must be paid before the expiry of the primary term in order to continue the lease beyond its primary term
    - The contention that the lessor by acquiescence, or by his words and his conduct, was estopped from denying the validity of the lease could not be given effect to, since on the proven facts, there was no representation by the lessor either by word or conduct on which a defence of estoppel could be founded, and the evidence failed to show that the lessor was ever aware that he had the right to treat the lease as terminated
- **Issue**
  - Is the lease alive at the time the well was finished? Is there any chance for an estoppel argument?
- **Analysis**
  - **Whether the drilling of the well and the shut-in payments continued the lease**
    - **The lease failed**
    - The continuous operations clause indicated that the primary term of the lease could be extended if a well was commenced before the primary term expired, if that well was drilled to completion and produced "paying quantities of O/G"
      - The term was extended by the clause, as the well had been started
    - However, the SIR was not made during the extended term, but only *after* drilling was completed
      - Recall: ***Murdoch*** says that "SIR's must be paid before the expiry of the primary term if it is to be effective to continue the lease beyond its primary term"
      - The lease was extended by operations, but the SIR cheque was not sent until 26 days later (no production/deemed production and no operations)
  - **Estoppel (fails)**
    - It was argued that there was estoppel by acquiescence because the lessor received royalty payments for 7 years after the lease expired; estoppel was refused
    - **Requirements for success in estoppel:**
      - (1) An unequivocal representation or conduct amounting to a representation intended to induce a course of conduct on the part of the person to whom the representation is made;
        - There must be clear and unequivocal representations made by the D, which did not occur here
        - The D, the possessor of the legal right, must know of the existence of his own right which is inconsistent with the right claimed by the P.
          - **Hambly did not know that he had the right to treat the petroleum and natural gas lease as terminated.**
      - (2) Reliance (by act or omission) on the representation, by the person to whom the representation is made
      - (3) Detriment to such person as a consequence of the act or omission.
      - (4) There must be existence of a legal relationship between the parties when the representation is made.
        - Estoppel CAN'T REVIVE A DEAD LEASE
    - The result is that the lessee is kicked off the land. This case leaves open a blatant and indisputable unjust enrichment claim

        - **Note that estoppel can be active or passive:**
            - 1) Actions or words which induce or encourage action to a party's detriment (active)
            - 2) By acquiescence (passive)
- **Holding**
    - No, the lease was not valid and subsisting because the SIR payments were not received during the primary term; there was a gap where no production took place; the estoppel argument fails
- **Ratio**
    - Shut in payment must be received during primary term (including temporary extension of term by a continuous operations clause) to continue a lease; if there is gap between completion of drilling and deemed production by a shut in payment, the lease is not continued
- **Notes**
    - Facts
        - Situation where Hambly's get shares which pay out if there's a royalty (like a lottery ticket); and these are tradeable; giftable, sellable
    - Issue
        - Did drilling or SIR extend lease beyond primary term?
    - Reasoning
        - Drilling completion and SIR payment: *Need actual or constructive production at the relevant time*
        - Thus, to rely on the SIR, it must be paid *prior* to the expiry of the primary term
        - "In the present case, the commencement of the drilling of the well, shortly before the expiration of the primary term, extended the term until drilling was completed (August 6, 1958). At that time, the term of the lease could only continue as a result of production, actual or constructive, and there was none. Accordingly the lease terminated on that date."
        - SIR payment not made until August 13th
        - Agree that the lease has terminated upon its own terms; no production, actual or constructive
        - **Is estoppel available, and to what effect? (p. 195)**
            - Generally meant to operate in circumstances where a legal relationship exists, and strict legal rights won't be enforced: 1) Actions or words which induce or encourage action to a party's detriment (active)?; or 2) By acquiescence (passive)?
            - Here, no word, conduct, or representations that would found estoppel

Estoppel

- Steps
    - 1) Unequivocal representation by Lessor
    - 2) Reliance on representation by Lessee
    - 3) Detriment to the Lessee as a result of reliance on the representation (e.g., drilling expenses)
- NOT available as a cause of action and requires an existing legal relationship when action/event in question occurs. Thus, estoppel *CAN'T REVIVE A DEAD LEASE*

Fatal Gap Problem/*Kininmonth* Problem – Summary

- 1. ***Kininmonth*** – production required as a condition precedent prior to operations clause becoming effective (at v. after)
- 2. ***Cull*** – gap in drilling → production (cured by unique clause; purposive interpretation)
- 3. ***Murdoch*** – gap in SIR payment (not cured by clause but rather by subsequent contract, which is really the only way to achieve this). As per ***Paddon-Hughes***, to take advantage of an SIR, it must be paid before primary term expiry

Republic Resources Ltd and Joffre Oils Ltd v Ballem (1982 ABQB) – Lease Expired At End of Primary Term; Repeat of *Kininmonth* Problem; Lessor Not Under an Obligation to Inform Lessee of the Lease's Validity; Estoppel Argument Fails; UE But No Restitution Because Well Capped, No Royalty Payments Made

- **Facts**
    - Republic (lessee) farmed out an interest in its leasehold rights to the P Joffre Oils Ltd. ("Joffre") in consideration of Joffre undertaking to drill on the leased property.
    - The well was drilled near the end of the primary term, and was completed after the end of the primary term. After the primary term had ended, natural gas was in commercial quantities and the well was prepared by the lessee for production and capped for lack of a market.

- There had been an effort to deal with the ***Kininmonth*** problem not in the habendum but in the extension/continuous operation clause
    - **Recall:** Proviso cannot modify the habendum
- Trying to cure the habendum through the proviso was fatal; it restates the ***Kininmonth*** problem: → <u>Proviso cannot modify the habendum</u>
    - "Provided further that if at any time after the expiration of the said primary term the leased substances or any of them are not being produced from the said lands and the lessee is then engaged in drilling, working or reworking operations thereon <u>*or if at any time after the expiration of the primary term production of the leased substances has ceased and the lessee shall have commenced further drilling, working or reworking operations on the said lands within 90 days after such cessation of production*</u>, then this lease shall remain in force so long as such operations are <u>*continuously*</u> prosecuted and, if they result in the production of the leased substances or any of them are produced from the said lands."
    - The lessee argued that the italicized portion allowed them to continue operations past the primary term, but it **did not remedy the fact that the habendum requires production** in order to extend the lease past the primary term.
        - Clause does not automatically extend the term of the lease if the lessee has not encountered production within the primary term.
        - Instead, what it does is allows a grace period if production ceases after the lease has been extended.
        - The result is that this lease is dead under the ***Kininmonth*** problem.
    - The only complicating factor was that the parties included another saving clause (an option to renew)
        - A clause gave 30 days to renew the option after its termination.
        - The lessee did not exercise this option because they didn't think there was any need to at this point.
    - Ballem (lessor) became aware of the invalidity during the 30 day option period, and waited to challenge the lease 36 days or so after the end of the lease
        - This is differentiated from other cases where the lessor was unaware of their legal rights. In this case the lessor was an expert of O&G leases and knowingly waited until the option expired.
- Republic claimed that the lease was valid and subsisting; in the alternative, they argued for compensation for the well they drilled, i.e. pay the drilling costs

- **Issues**
    - (1) Whether the lease is still valid and subsisting, or whether it expired at the end of its five year primary term?
    - (2) Were the lessors under an obligation to inform the lessees of the invalidity?
    - (3) How did the court provide justice to the parties?
- **Analysis**
    - **Valid and subsisting lease?**
        - Lease expired at the end of the primary term because there was no production ongoing; a proviso cannot modify the habendum as it was worded (it still required for there to be production in the primary term before it could be activated)
    - **No obligation to notify within 30 day option period**
        - Oil Co argues that by waiting until the end of the 30 day option to renew period, that the Ballems had deprived them of their right to renew.
            - <u>No case law that establishes such an obligation to inform; silence is not a representation that the lease is still valid and subsisting</u>
            - NO DUTY TO DISCLOSE TO OTHER PARTY THINGS RELEVANT TO THEIR LEGAL POSITION
        - In the case of a unilateral option to renew, when the option is not made by the holder of the option, the lease automatically terminates
    - **No Estoppel by silence here**
        - **5 things that must be proven to show:**
            - (1) Plaintiff (lessee) must have made a mistake as to his legal rights
                - Met in this case. Plaintiff thought lease was extended so they didn't have to exercise option to renew
            - (2) Plaintiff must have expended money or done an act on the faith of their negative belief
                - Here it was a negative action, failure to exercise their option
            - (3) The defendant (lessor), aka the possessor of the legal right, must know the existence of his own right to declare the lease invalid which is inconsistent with the position claimed by the defendant
            - (4) The defendant must know the P's mistaken belief in his rights
                - Republic is the one mistaken in this case, not the defendant, so the test is not met
            - (5) The defendant must have encouraged the plaintiff either directly, or indirectly by abstaining from asserting his own legal rights
                - In this case the answers given in testimony make it hard to assert that D knew his right was inconsistent with plaintiff's
        - **Estoppel:**
            - Acceptance of the royalty payment (***Hambly***, ***Sohio***), as had been discussed above in many cases, is not conduct that indicates an unequivocal representation that the lease is still valid
            - Again, the OilCo relied on their own legal counsel, rather than on any representation by the lessor

                - May be theoretically available sometimes, but has not been successful
        - **Unjust Enrichment** (addressed more consciously by the court, yet still not thoroughly)
            - OilCo asks for $190K in restitution for the cost of drilling the well
            - Elements:
                - (1) Deprivation: OilCo drilled the well at their own expense
                - (2) Corresponding benefit: Ballem is left with a capped well
                - (3) Absence of juristic reason: Well was drilled under the lease, so the lease provides a juristic reason *for drilling a well*.
                    - **But** the expiration of the lease removes any reference to a juristic reason for the benefit
            - **However, other points:**
                - (**(1) Unofficious trespasser:** Satisfied.
                    - OilCo mistakenly let the lease expire, and did not blatantly exploit the Bellams' rights
                - **(2) Incontrovertible benefit:** Not satisfied
                    - No free acceptance as in ***Weyburn***, where the lessor had knowledge of the ongoing operations and accepted royalties.
                    - Rather, in this case there is an unascertained benefit conferred on the defendant.
                    - This well was in close proximity to 13 other capped gas wells thereby casting doubt on whether the costs of drilling the well are proportionate to the "benefit" conferred on the Ballems.
                    - There is no authority for the court to impose a lien/charge against the future net proceeds of production to offset the costs of the well.
                    - The OilCo took a calculated risk by starting drilling late in the lease
        - **So… Ballem receives a fully functional gas well, and oil company is kicked off the land!**
- **Holding**
    - Lease expired at the end of the primary term; the lessors were not under an obligation to inform the lessee of invalidity; and the court consciously addressed unjust enrichment
- **Ratio**
    - Where parties used "after" but could have used "after or at" in lease (would have cured the gap), courts unlikely to read that language in
    - Estoppel and UE hard for lessee to make out
- **Notes**
    - Gap! After primary term, a few days where there was no actual or deemed production (p. 197)
    - Attempt to deal with *Kininmonth* problem in proviso to habendum (p. 197)
        - *It did **not** successfully change the "after" to an "at" though*
    - *Recall*: proviso to be read in view of habendum
    - *Recall*: if production is needed, can be deemed or real
    - Facts
        - *Further problem*: parties included an option for lease renewal, open for 30 days past primary term expiry (p. 198)
        - Application complicated by the fact that Ballem waited until *after* option for renewal expired to notify of lease invalidity
    - Issues
        - Lessor obligation to inform within option period? How to achieve justice between the parties?
    - Holding
        - **No timely SIR payment & No effective Proviso (p. 198)**
        - **No obligation to notify within 30-day option period**
            - No contractual obligation to notify other party of this sort of fact & no misrepresentation made
            - No estoppel by silence:
                - 1) Plaintiff makes mistake as to legal rights; 2) Expends money on this belief; 3) Defendant knows of inconsistent legal right and; 4) knows of Plaintiff's mistaken belief; and 5) encourages Plaintiff's expenditure of money in other actions or by not asserting legal right (*fails here*)
        - **Remedies - unjust enrichment?**
            - Steps
                - A party received a benefit,
                - The claimant suffered a loss corresponding in some way to the benefit, and
                - There was no juristic reason for the benefit and the loss
            - Oil company seeks restitution for drilling ($200,000)
            - 1) Unofficious trespasser? *Yes*. Mistaken belief
            - 2) Incontrovertible benefit? *No*. Oil company took a calculated risk given the state of the gas field and 11th hour in the primary term. Ballem had yet to benefit
        - So… Ballem receives a fully functional gas well & oil company is kicked off the land!

Back to *Sohio*: Remedies – UE? Trespass?

- Lessor wanted 12 years of proceeds
- Lessee allowed to keep proceeds until point that action was started
    - Why? Unofficious trespasser (yes!) and incontrovertible benefit (yes!). Look to deprivation; enrichment; absence of juristic reason
    - When to calculate it? Here, at *writ of summons*

3. PRODUCTION

Basic Habendum and Common Proviso Language

- **Basic Habendum:**
    - "…to have and enjoy the same for 10 years from the date hereof and so long thereafter as the leased substances or any of the are produced"
- **Common Proviso language & lease lifecycle:**
    - "…if at anytime during such term and after the discovery of production of said lands and if such production shall cease and all wells shall be abandoned, then this lease shall terminate on the next anniversary date"
- Canada lacks a clear common law definition of 'production'
- Thus, cases turn on a lease by lease analysis
- "Commercial production" is commonly defined (recall: offset well scenario)
- In the event that the lease fails to define production, then the court may look to "commercial production" for guidance
- If not, where else could we look? Answer: *American reasonable operator test*

Clifton v Koontz (1959 US Texas SC) – Reasonable Operator Test; American Understanding of Production

- **Facts:**
    - Marginal gas well, operating at a slim profit. Evidence indicated that the well alternated between being profitable (years) and not being profitable (months); overall it was producing at "paying quantities" since profit exceeded operating and marketing costs
        - Well can be marginal if producing intermittently or if it's marginally profitable
- ***Reasonable operator test*:**
    - Would a reasonably prudent operator, for the purposes of profit and not speculation, continue to operate the well in said manner?
        - If **yes**: production. If **no**: production fails
        - What you don't want is an operator tying up land – this is a way to combat that

Omers Energy v Alberta (ERCB) (2011 ABCA) – Extension of Lease Through Shut-In Well Clause Not Met; Meaning of "Capable of Producing"; Capable of Producing Meaningful Quantity in Existing Configuration (Immediately, Without Further Work Required)

- **Facts**
    - A lease was granted and Omers received a well license to drill under this lease. Lease would have normally ended Jan 6, 2006, but it was producing so the lease was extended.
    - Well had a checkered history of production at best, producing only 3 times for short durations through 2006; otherwise, it was shut-in
    - It was still shut in by July, 2007, when the successor to the lessor entered into a new lease with a different lessee
    - Omers nevertheless drilled two new wells and put them into production until their licenses were revoked
    - Omers appealed the decision of the Energy Resources Conservation Board (the Board) to suspend the two gas well licenses because the underlying lease had expired
        - Omers had sought to rely on the Suspended Wells Clause in the lease to extend its term.
        - That clause continues a lease as though operations were being conducted, provided the well was "capable of producing the leased substances" and shut in
- **Issue**
    - What level of production is required for the initial lease to remain valid and subsisting?
- **Analysis**

- **Standard of review:** correctness because the Board does not have expertise in interpreting contract and statute, and interpretation of statute suggests a question of law
- The Court looked to the intentions of the parties to determine the meaning of "capable of producing" by reading the habendum clause, the continuing operations clause, and the shut-in well clause together
    - The test used was an objective standard: what a reasonable person would infer from the words used by the parties
        - **Habendum Clause reads:**
            - TO HAVE AND ENJOY the same for the term of FIVE (5) years (herein called the "primary term") commencing on the date hereof [February 8, 2001] and continuing so long thereafter as operations (as hereinafter defined) are conducted upon the said lands, the pooled lands or the unitized lands, with no cessation, in the case of each cessation of operations, of more than 90 consecutive days.
            - Interpretation:
                - Lessee has five years to commence operations, once the five-year period ends the lease will expire unless a lessee is producing, recovering injected substances, drilling, or conducting other specific enumerated activities, **without a cessation of more than 90 days**.
        - **Shut in Well Clause:**
            - If, at the expiration of the primary term or at any time or times thereafter, there is any well on the said lands, the pooled lands, or the unitized lands, **capable of producing the leased substances** or any of them, **and all such wells are shut-in or suspended**, this Lease shall, nevertheless, continue in force **as though operations were being conducted** so long as… no cessation, in the case of each cessation of operations, of more than 90 consecutive days.
            - Interpretation:
                - **For the Suspended Wells Clause to apply to extend the lease, there must be either:**
                    - A shut-in well on the lands that is capable of producing,
                    - Or if the well is not capable of production, operations, as defined in 1(g), must commence with no cessation of more than 90 consecutive days between successive operations
- **"Capable of producing" required:**
    - 1) The capability to produce (in its existing configuration and state of completion); AND
        - Meaning… turn the valve and the well is producing
    - 2) The capability to produce meaningful quantities of the resource (some volumetric quantity of NG)
        - Meaningful: quantity that is sufficient to provide a reasonable expectation of profits
        - This is similar to (but not the same as) the meaning of producing in a "paying quantity" in the US. It is not an issue if the production is clearly profitable (i.e. it does not require precise quantification).
        - Would an objectionably reasonable operator, acting prudently and for the purpose of making profit (not mere speculation) continue to operate the well in the same manner?
            - Viewed objectively, an owner would not tie up property indefinitely for a quantity of production that would never pay
- **Application:**
    - The water logging problem being faced by *Omers* meant that the well was not capable of meaningful production in its current configuration or state of completion.
    - This was differentiated from ***Bearspaw*** where the well was capable of immediately producing NG, but there was no pipeline available to allow for its transport.
        - ***Bearspaw*** also used the term producible rather than capable of production
    - It was never intended that the shut-in well clause could allow a lessee to hold a property for purely speculative purposes
- ***Clifton* Test applicability**
    - American "paying quantities" test (Clifton) & whether this requires a moment by moment accounting
        - Court did not completely endorse that test and they did not say that there needs to be moment by moment accounting
    - ***Clifton* test for "in paying quantities":**
        - Whether, in all the relevant circumstances, a reasonably prudent operator, for the purposes of making a profit and not merely for speculation, would continue to operate a well in the manner in which the well in question was operated
        - Is there is a reasonable expectation of profitable returns from the well?
        - "Capable of production in paying quantities" means a well that will produce in paying quantities if the well is turned "on"
    - **BUT:** The parties did not choose to include "in paying quantities" in Clause 3 of the Cymbaluk Lease.
        - Court agreed with the Board that the words "in paying quantities" should not be implied
- **Conclusion**
    - Omers loses the bad well AND new producing well since it was drilled on the lands after the lease had expired and was not extended due to not producing meaningful quantities.

- **Holding**
  - Appeal dismissed; lease was no longer viable
  - **"Capable of producing the leased substances" required:** 1) the "demonstrated, present ability of a well on the lands to produce the leased substances in a meaningful quantity, 2) within the time frames contemplated in the lease." (i.e. a non-producing well had 90 days to be revived). E.g. the well must be ready and able to produce gas (in the required quantity) when the tap is turned on
- **Ratio**
  - "Capable of producing" means 1) the capability to produce (in its existing configuration and state of completion - Meaning… turn the valve and the well is producing); AND 2) the capability to produce meaningful quantities of the resource (some volumetric quantity of NG that is sufficient to provide a reasonable expectation of profits) – so those conditions must be fulfilled for there to be a valid shut-in (CAN'T JUST SHUT IN A WELL FOR SPECULATIVE PURPOSES; MUST BE A SHUT IN OF A WELL THAT COULD BE PRODUCTIVE)
- **Notes**
  - Facts (p. 199-200)
    - Suspended well clause is important here; this is an example of poor lease drafting
      - "If, at the expiration of the primary term or at any time or times thereafter, there is any well on the said lands, the pooled lands, or the unitized lands, **capable of producing the leased substances** or any of them, and all such wells are shut-in or suspended, this Lease shall, nevertheless, continue…"
        - If capable of producing, it will continue
  - Issue
    - Was there an error in the ERCB's interpretation of the Suspended Wells Clause phrase "capable of producing the leased substances"?
    - What is the effect of requiring "meaningful production" in present state and configuration?
    - Standard of Review?
      - *Important to note, but don't need to know in any detail*
  - Analysis
    - Standard contract interpretation process
    - Habendum/operations clause & Suspended Wells clause – bad drafting? (p 201-202)
    - "Capable of producing the leased substances"
    - American "paying quantities" test (*Clifton* and marginal wells) & whether this requires a moment by moment accounting (p 203)
    - Did the ERCB read words into the contract?
      - Court: ERCB was correct and reasonable in the circumstances
    - "Capable" – in existing configuration & state (i.e., "must be ready and able when the tap is turned on") (pp. 205-206)
      - Must be ready when you turn the tap on
      - If it needs to be re-worked or a lot of maintenance has to happen, then this isn't capable
    - "Production" – meaningful quantity required; a volumetric condition
      - You shouldn't see a well as productive if it simply makes a puff/drop of gas/oil
      - The purpose of a lease is to generate a profit
    - Underlying lease had terminated

Bearspaw Petroleum Ltd v Encana Corp **(2011 ABCA) – Extension of Lease Through Clause That Allows for Extension If Well is "Producible"; Ability to Produce Quantifiable Amount, Even If it Still Requires Pipeline to Be Built**

- **Facts**
  - Bearspaw had drilled several NG wells that tested well for volume of NG, but were not connected to an existing pipeline. Enbridge challenged the validity of these leases on the basis that the leases were expired because this did not meet the requirement of being "producible"
  - This is an appeal by Encana Corporation from a declaration that the Respondent, Bearspaw Petroleum Ltd., had a valid and continuing petroleum and natural gas lease
- **Issue**
  - What is meant by the term producible? Is the lease continued because the wells are "producible" even though production has not commenced on account of the wells not yet being tied into a pipeline?
- **Analysis**
  - **Appellant (Enbridge) argument:**
    - Producible means to be capable, without more, of immediately being put into production in commercial quantities.
  - **The Respondent (Bearspaw):**

        - Argues it means to be capable of being put into production in commercial quantities upon certain other steps being taken, in this case, being tied into a pipeline
    - **Court:**
        - Courts said that the parties meant something when they chose "producible" over "produced"
            - Court says all that lessee has to do is open a valve and the well is producible without further work on the well itself.
            - Plain and ordinary meaning of the word "producible" means something less than capable of immediate production, with no more to be done than turning on a valve.
            - Royalty obligation was triggered not when the natural gas was producible but only when it was "produced, saved and marketed", thereby suggesting that "producible" means something other than "produced, saved and marketed".
        - The requirement that a pipeline exist for every completed NG operator to maintain their lease would not be **commercially viable.**
            - Given the expense of building a pipeline and the practicality of determining the presence and volume of production before undergoing that expense, this interpretation would be both commercially unfeasible and even absurd
        - Producible does not mean that the well must be capable of immediate production, but rather additional steps may be required to bring the NG to market.
    - **Has the lease nonetheless terminated for breach of an implied covenant to market the natural gas which the wells would produce?**
        - There is no implied or express covenant that a pipeline must be tied in to bring gas to market prior to completing the wells.
        - If the market is not such that it would be economical to physically produce and sell the natural gas, the Respondent is not required to do so
        - Fact that the Respondent chose to first build other pipelines and tie-in other wells to maximize its own profits does not defeat the fact that it has a plan to bring the leased lands to market, which is all it is required to have under clause 4 of the contract
- **Holding**
    - Appeal dismissed; Bearspaw's lease is valid and continuing
- **Raito**
    - Producible means the ability to produce quantifiable amounts of natural gas, but does not require that everything be completed to bring the gas to market (i.e. a pipeline)
- **Notes**
    - Issue
        - Primary term has expired without production
        - Interpretation of habendum: "so long thereafter as the leased substances or any of them are *producible* from the leased area"
        - Does this require immediacy or allow for certain additional steps?
    - Analysis
        - Standard of review?
        - Two issues (p. 208) turn on the search for a sensible commercial result from a unique habendum
        - First issue: Agrees with trial judge that something less than immediate production is appropriate (practically, this makes sense for commercial reasons)
            - Producible – something less than immediacy will do
                - If you're the lessee and this is the language, this gives you leeway – allows you to develop the well and determine how to tie things in
        - Second issue: Implied covenant to market? (see Clause 4 at p. 210)
            - Clause 4 allows for reasonable diligence:
                - "If and when production is found in commercial quantity in any well drilled on the leased area, the Lessee will continue with reasonable diligence to drill for and develop the property so as to produce the leased substances in paying quantities upon the entire tract, having regard at all times to existing geological and marketing conditions and with a view to the orderly development of the leased area on geological lines (rather than on property divisions) and in the manner best suited to the recovery of the greatest quantity of the leased substances at the least cost..."
    - Note: If asked a question on when a lease normally ends
        - It's when production stops
            - Need to look at production definition
        - If not defined, look at reasonable operator test

4. THE SHUT-IN WELL CLAUSE

Overview

- Permits the lessee to shut-in a well, stopping **actual** production, but maintaining the lease through **deemed/constructive** production
- Deemed production requires timely payment by the anniversary date
    - Usually want to make as an advanced payment, so there's no fatal gap
- Exists as an OPTION and not an OBLIGATION
    - Why does this matter?
        - Obligations will trigger a default period to fix the issue (options won't)
- Highly situation-dependent, but often includes (a well written lease will have examples to allow for shut-in):
    - Lack of/intermittent market
    - Causes beyond the lessee's control
    - Good oilfield practice
- Who bears the onus?
    - The party seeking to take advantage of the shut-in royalty clause
        - Sometimes the plaintiff lessor will have the onus of showing that the lease is invalid, but if the issue turns on whether a shut-in was made for a valid reason, the onus will be placed on the lessee to show that the shut-in was made for a valid reason
    - The onus is always on the lessee who wants to shut in to prove that they fall within the proviso to excuse non-actual production (i.e. that the well is shut in for one of the 3 reasons above)
- **NOTE:** The ability to shut-in a well in accordance with the lease will depend upon the actual wording of the lease's shut-in well clause
    - ***Durish***, ***Teg*** and ***Freyberg*** are a trilogy of cases where the lessee claims to be shutting in the well for one of the 3 valid reasons included in the SIR clause, but they are really doing so for their own convenience, and the court denies them the use of the shut-in well clause
        - In ***Durish,*** they claimed that their actions fell within "good oilfield practice"
        - In ***Teg,*** they claimed shut-in the well due to "lack of market and transportation facilities"
        - In ***Freyberg***, they claimed that there was "no available market"
    - **Clash of interests:**
        - The lessee will prefer to broadly worded shut-in well clauses

Kissinger Petroleums Ltd v Keith McLean Oil Properties Ltd (1984 ABCA) – SIR Payment Made in Contemplation of a Shut-In Well is Effective for Deemed Production and Continued Lease

- **Facts**
    - Kissinger was drilling at the end of the primary term of their lease and the lease was extended by operations. They were worried that operations would result in a capped gas well, so they sent a cheque to the lessor saying the cheque was a shut-in royalty (SIR) payment. They finished operations and shut in the well. They then sent a letter saying they got a well and the cheque they sent should be taken as a SIR payment. The cheque was received before operations ceased.
- **Issue**
    - Can the payment of a SIR be made in advance?
        - Case law was creating a catch 22—you cannot pay SIR until you have production, but you cannot drill the well, discover it's a gas well and have a delay between finishing the operations and paying the SIR payment (fatal gap of no production or deemed production)
- **Analysis**
    - Kissinger addressed the "fatal gap" danger by paying the royalty in advance in anticipation of operations ceasing.
        - In contrast, in ***Hambly*** there was no timely payment of the SIR, and there was a 5 day gap between the operations and production, so the lease died. ***Hambly*** dealt with deemed production.
        - Court has said that it is appropriate to pay the shut-in royalty clause at the time that they decide that they will shut-in the well upon finalizing operations
    - Also in contrast, in ***Cull*** the lease was extended so long as the well was brought into production within reasonable diligence and dispatch. ***Cull*** dealt with actual production
    - Court should adopt a construction which results in a reasonable result rather than one which gives an unreasonable result
    - **Key point:** Points to the difficulty of getting deemed production. Lessee was smart and sent the SIR cheque before they actually shut in the well. Court said this was fine even though a lessee may not know ahead of time whether they qualify as having deemed production.
        - **Future issue:** lessor may be able to refuse to accept the SIR payment if it is made before operations on the well has even been completed (the courts have yet to rule on that question)
- **Holding**
    - Yes. An SIR payment made in advance and in contemplation of a shut in well does not impair its efficacy as a royalty payment.

- **Ratio**
  - Shut in royalty payment made in contemplation of a shut-in well before operations of completing the well have been finished will be an adequate way of ensuring that there is no gap between operations and production or production and deemed production (**Kininmonth** *problem)* – okay to pay the SIR at the time that the lessee decides not to produce upon completion of the well
- **Notes**
  - Facts (p. 211)
    - Proviso 3 is important here
      - AND FURTHER ALWAYS PROVIDED that if at the end of the said term the leased substances are not being produced from the said lands and the Lessee is then engaged in drilling or working operations thereon, or if at any time after the expiration of the said term production of the leased substances has ceased and the Lessee shall have commenced further drilling or working operations within ninety (90) days after the cessation of said production, then this Lease shall remain in force so long as any drilling or working operations are prosecuted with no cessation of more than ninety (90) consecutive days, and, if such drilling or working operation's result in the production of the leased substances or any of them, so long thereafter as the leased substances or any of them are produced from the said lands; provided further that notwithstanding anything hereinbefore contained or implied to the contrary, if drilling or working operations are interrupted or suspended as the result of any cause whatsoever beyond the Lessee's reasonable control or if any well on the said lands or on any spacing unit of which the said lands or any portion thereof form a part, is shut-in, suspended or otherwise not produced for any cause whatsoever which is in accordance with good oil field practice, the time of such interruption or suspension or non-production shall not be counted against the Lessee.
        - The time does not count against you so that the 90-day clock doesn't expire
  - Issue
    - Timing of payment for a SIR and whether or not the lease makes it validly into the secondary term
    - *Concern*: fatal gap problem resulting from operations beyond the primary term, as allowed by the habendum, that might result in a capped well
  - Solution: Kissinger paid in advance!
  - Court accepted this practice noting that it is appropriate to pay AFTER the decision to shut-in is made but before actually shutting in is executed
    - Can avoid a gap by paying in advance
  - Could be problematic if the lessor refuses to accept payment
    - They leave for another day whether a rejection could change the interpretation

Durish v White Resource Management Ltd **(1987 ABQB) – "Good Oilfield Practice" Under a Shut-In Royalty Clause Not Including Lessee/Farmor Dispute; Lease Not Validly Extended; Payment of the SIR is Not an Obligation; Rather it is an Option/Privilege Open to the Lessee and Notice by the Lessor Not Required to End the Lease**

- **Facts**
  - Durish was the assigned lessor and White was the lessee for a well that went into production. The lessee had a farm out agreement with Gulf and was in arrears for processing costs owed to Gulf. They were fighting over these costs.
  - With the Jumping Pound formula, the lessee is entitled to deduct from the revenue the costs of transmitting and processing the gas in order to come up with the royalty.
  - As a result of the dispute, Gulf shut in the well.
  - Because the lease was extended by production into the secondary term of the lease, White (the lessee) argues that the terms of the habendum relating to non-production for any cause whatsoever which is in accordance with "good oilfield practice" applies to this dispute and that the lease is therefore valid and subsisting.
  - In the alternative, White argues that they have paid the SIR, albeit late. In the further alternative, White argues that they were entitled to notice of breach of contract.
- **Issue**
  - **(1)** Does Gulf's shutting in of the well as a result of White's non-payment of fees trigger "good oilfield practice" such that the lease is valid and subsisting?
  - **(2)** Is the payment of SIR's 7 months after production ceased a reasonable period of time?
  - **(3)** Is the payment of SIR an obligation under the lease such that White was entitled to notice of breach?
- **Analysis**
  - Interpretation of the lease: the different clauses and habendum were read separately to interpret their meaning
    - Court said:
      - Shut-in payment would be okay for covering any reasons, regardless whether there was good oilfield practice; OR

                - Good oilfield practice would be valid for a shut-in, and no SIR would be necessary to extend the lease
            - Proviso 3 – first scenario
                - If a break in production, third proviso usually gives lessee 90 consecutive days to get production going again (grace period)
                - If 90-day clock expires, then you can have termination
                - This clause operates to stop that clock - 90 days won't run at all
                - But must be in accordance with good oilfield practices
            - Shut-in well clause – second scenario
                - At end of the year within secondary term, if there hasn't been production, lessee can pay to continue into next year
                    - deems actual production
                - Different than situation where you have a break in actual production for less than 90 days
                - What is the obvious concern? No limitations
                    - Lessor can shut-in, make a timely payment, and keep it going
                    - Language is hugely disadvantageous for lessor
                    - Should impose conditions for when a shut-in can happen
    - **(1) Does shutting in the well over a dispute over the payment of processing fees fall within the ambit of "good oilfield practice"**?
        - A contractual dispute between the farmor and farmee was not a sufficient reason to shut in the well. Since the shut in was invalid, and the production ceased for 90+ days, the lease expired.
    - **(2) Was White's late payment of the SIR sufficient to extend the lease?**
        - The lease indicated that if there was no production (for 90+ days) then the SIR must be paid "at the expiration of the year."
            - The court interpreted this to mean payment on the anniversary date or within a reasonable time before or after such anniversary date.
        - Here, anniversary date of the year in which production stopped was May 27, 1986 and payment was made on January 17, 1987
    - **(3) Was the lessee entitled to a notice of default when the failed to pay the SIR?**
        - Payment of the SIR is NOT an obligation; rather it is an option/privilege open to the lessee to continue the life of the lease if he so chooses. An obligation is something that you are required to do.
        - Here, if the lessee fails to pay the SIR, there is no requirement that the lessor inform him, since there is no breach. In the event of non-payment, the lease expires.
- **Holding**
    - No, Gulf's shutting in of the well for non-receipt of fees from the lessee was not good oilfield practice sufficient to extend the lease;
    - No, the SIR payment was not received in the time permitted by the lease;
    - No, the lessee was not entitled to a notice of breach for failing to pay the SIR (affirmed by the ABCA)
- **Ratio**
    - Payment of the SIR is NOT an obligation; rather, it is an option/privilege open to the lessee to continue the life of the lease if he so chooses so the lessor does not need to give a notice of the lease ending when the SIR is not received; "good oilfield practice" for shutting in a well does not include a dispute over payment between the lessee or the operator they farm out to
- **Notes**
    - The court softened the payment provision of the SIR, holding that payment can be made within a "reasonable time either before or after such anniversary date. Did so on the basis that the "at" in "the lessee shall pay the lessor at the expiration of each such year…" is imprecise and only means nearness and proximity and therefore denotes a reasonable time
    - Issue
        - Lease terminated for invalid shut-in during secondary term?
        - Processing/transportation dispute & shut-in for "good oilfield practice" for delays beyond 90 days
    - Analysis
        - Review of circumstances (p. 215)
        - Processing and transporting falls within "good oilfield practices" BUT failure to come to a timely resolution of the contract dispute does not qualify
            - "I am unable to find that the contract dispute between Gulf and White, albeit relating to both transmission and processing fees, comes within the ambit of "good oil field practice"."
                - A mere contractual dispute doesn't come within the sphere of good oilfield practice
        - Further, payment of the SIR was not timely. It is an option that must be exercised expeditiously and the lessor does not have an obligation to notify

549767 Alberta Ltd v Teg Holdings Ltd **(1997 ABQB) – Lessee Failed to Show that Shut In for 20 Years was Defendable on Basis of Lack of Market and Transportation Facilities**

- **Facts**
  - Lessors (the numbered company) had two leases with Chevron (the lessee). Chevron drilled one well in 1973 and another well in 1976 and paid a shut in royalty payment the lessor;
  - Telstar Resources Ltd. ("Telstar") acquired Chevron's entire interest as lessee under both leases subject only to an overriding royalty of 15% in both leases.
  - TEG acquired Chevron's overriding royalty interest in 1992.
  - Telstar was the operator of the lease from 1976 to 1994. Telstar then quit and claimed its entire interest under each of the leases to TEG.
  - For 20 years the well had remained shut in with no ongoing production on the alleged basis that there was no available transportation or markets for the gas.
  - The lessor now claims that the leases have expired for the lack of production.
- **Issue**
  - Whether defendants' failure to produce the wells is "as a result of a lack of, or an intermittent, market or lack of transportation facilities or any other cause beyond the lessee's reasonable control."
- **Analysis**
  - The onus is always on the oil company who wants to shut in to prove that they fall within the proviso to excuse non-production
  - **Transportation:**
    - Here, the nearest pipeline was only 3 miles away from the wells, which would have had capacity for the lessee's gas
    - They could have negotiated with the carrier or applied for a common carrier
  - **Lack of market:**
    - With regards to the lack of market, the court held that at some point during the 20 years the market for gas was good and sometimes even great
      - When you read between the lines the problem was that transportation was too costly, not impossible
    - Sufficient evidence: can be indicia of the market, transportation, expert and non-expert evidence
  - Bottom line: They did not fulfill any of the requirements under the SIR clause
- **Holding**
  - No; the lessee could have applied to the ERCB for an order to declare a pipeline a common carrier, and an order to declare the processing plant a common processor; the leases expired no later than 1987 when both transportation and a market were available for any natural gas which could have been produced from the wells.
- **Ratio**
  - A lessee has a fairly strong onus to prove that the cause of them shutting-in the well is actually outside of their control.
  - The court will not allow a lessee to avoid production (i.e. keep a subsisting lease) simply because it is not commercially favorable to their own interests (for reasons outside of general market conditions)
- **Notes**
  - Facts (p. 216-217)
    - P's submit that the leases expired since the wells haven't produced any NG beyond the primary term, and haven't produced anything in the last 20 years
    - Unless the D's (lessee) can establish what's in the proviso clause, the lease has expired
  - Issue
    - Availability of transportation facilities and/or market
  - Analysis
    - Onus / evidence / recourse to the regulator
      - Onus is on the D lessee to show they fall within the proviso language to excuse production
      - There is going to be different evidence that they can bring
      - Court looks at the transportation capacity available to determine if there's actually capacity – becomes an evidence-gathering exercise
      - There was indeed a transportation facility that was available
      - It may have been within Telstar's power to force Norcen to transport its natural gas down its line. Mr. Farries, expert for the plaintiffs, testified that in the event a party finds itself in the position where it is unable to move its gas down an existing gathering system, that party can apply to the AEUB under the Oil and Gas Conservation Act and Regulations for a Common Carrier Order
        - There was a capacity available and they didn't take it

Freyberg v Flecher Challenge Oil & Gas **(2005 ABCA) – Identical Clause to *Teg*; Test to Determine an Economic and Profitable Market**

- **Facts**
  - Lady Freyberg inherited 2/3 interest in a mineral title to certain lands in AB, and a well was drilled in 1979. Despite positive test results, the lessee decided to shut-in the well for a period of 21 years, citing a lack of market and they were paying SIRs so they were within their rights.
  - The shut-in well clause was limited and said you can shut in only as a result of lack of economical/profitable market.
  - When the well was finally put to production (1999) the plaintiff's well-head had the highest level of production in the field.
  - In reality, the lessee only had a 25.83% interest in that well, and they had another well in the field with a 51.66% interest. Therefore, the lessee could increase their return by increasing production from one of the other wells in which they had a greater interest (acting in their own economic interest)
  - Lady Freyberg sued the lessee, arguing that the lease had terminated at the latest of 1987 because there had been no good reason not to produce in the face of the market and economic conditions at the time
  - Trial judge denied her request and she appealed that decision.
- **Issue**
  - Did the lessee have reason to shut-in the well due to the lack of an available market?
- **Analysis**
  - **Court said that <u>strict construction of shut-in clause was appropriate</u> given policy reasons of:**
    - Desire to see production from the well
    - Risks to the well
      - Lengthy shut-ins pose risks for the productivity of the well (changes in reservoir, water flooding within the well, damage to the well)
    - Risk that the substance will be captured by other wells
      - Reservoir can be drained from neighboring lands
  - **Did the Lease automatically terminate during the secondary term?**
    - Fourth proviso simply extends the Lease when a well drilled within the initial term is shut-in due to an intermittent, uneconomical, unprofitable or absent market.
    - This proviso is subject to Clause 3 which imposes an additional obligation on a lessee: payment of a sum equivalent to the delay rental on the anniversary date of the Lease.
    - Once the uneconomical and unprofitable production condition is met and the delay rental is subsequently paid, the lease extends for a further one year period
    - <u>If there was an economic and profitable market, on the anniversary date of the lease, there is no deemed production and the lease terminates.</u>
  - **Was there an economic and profitable market for the 6-3 well (Lady Freyberg's well) prior to 1999**
    - **Onus:**
      - Onus is on the lessee to show that there was valid deemed production to extend the lease
      - Must show that an economical and profitable market did not exist, so the well can be shut in the well pursuant to the terms of the lease, and production is deemed, allowing the lease to be extended
    - **Court considered relative operator interests, resisted production, and activity on adjacent plots**
      - Can look to expert evidence, but also other factors such as productivity of surrounding wells
      - Evidence proved that there were lots of good markets for gas during those years, especially because the lessee was producing from the same pool with a different well during those years
      - Each side brought their own experts, but judge said no need because there was overwhelming evidence that there was a very profitable market for gas prior to 1999
  - **<u>Objective Test for determining whether there was a "profitable market":</u>**
    - <u>Would a prudent lessee based on the information that they had available at the time have foreseen profitability?</u>
      - **This is an objective/subjective standard, as a prudent lessee is determined by the:**
        - **(1)** Character and nature of the lessee and
          - Lessee experienced in the production of leased substances will be held to a higher objective standard than an inexperienced lessee
        - **(2)** The reasonable expectations of the parties
  - **Compensation**
    - Does not receive net proceeds of production
    - Freyberg's investment history was examined and it didn't show any propensity for her to put her money at risk
    - She would not have produced the land herself, she would have gotten someone else to do it for a better bonus and royalty (like *Montreal Trusts*)
- **Holding**
  - Appeal allowed; the lease expired because the facts were not sufficient to show unavailable market that would support not producing from the well
- **Ratio**

- Lessor not obligated to bring failure to make appropriate SIR payment to lessee's attention (disadvantage of information and SIR is an option, NOT an obligation). Strict construction of SIR payment clauses. Objective test for availability of market: whether, based on information available, a prudent lessee would have foreseen profitability in this circumstance.

- **Note**
  - The court took a strong stance once again that habendum is going to be strictly interpreted
  - Facts
    - F mad that well was shut-in; she wants to kick the lessees off the land
    - There's been 21 years of delay
    - Reason Fletcher shut in: They were getting better royalties from other leases, so they kept these ones shut in
      - *Is this fair? Likely not*
    - Trial Judge
      - Went rogue; found no problem
      - If there was a problem, the only remedy would've been damages
    - Language in question:
      - Connects Clause 3 to the Habendum, so should be read together
  - Issue
    - Termination of lease for lack of actual or deemed production?
    - Does Lessee have to give notice of default?
    - When/how do we assess the existence of a profitable market?
  - Analysis
    - Resounding dismissal of the trial judge's reasoning (p 218)
    - Court considered relative operator interests, how the operator resisted production, and activity on adjacent plots
    - Found that failure to produce, when economical to do so, terminates the lease
    - Rejected the trial judge's application of the default clause
      - It was not an obligation to give notice of default
    - Strict construction of shut-in clause appropriate:
      - Desire to see production
      - Risks to the well
        - Shutting in for 21 years could lead to physical and economic risks
      - Risk that the substance will be captured by other wells
        - Lady F is losing her opportunity
    - *Objective test for market*: whether, based on the information available, a prudent lessee would have foreseen profitability and would've pursued it
      - If they would've seen profitability, the shut-in is invalid
      - Looks like the "production" analysis
    - *Onus of proof:* Freyberg with the onus to prove her case, but defendant lessee with specific onus to prove proper reliance on shut-in well clause—exception + knowledge (*Snell v Farrell*)
      - There's an information imbalance: The O/G company knows the market and has the knowledge, so it makes sense to put the burden on them
    - *What evidence to look to*? Expert evidence isn't necessary because of overwhelming lay evidence
      - If there isn't lay evidence, you can look to expert evidence to try and present what's happening
    - This is a good case for operation of a shut-in well

Kensington Energy Ltd v B&G Energy Ltd **(2008 ABCA) – Shut-In Well Clause Just Required Payments; Shut-In Well Payments Made, So Production Deemed and Lease Continued; (Note: Lease Language Almost Identical to *Durish*); Proviso 3 is Unique from Shut-In Well Clause**

- **Facts**
  - In 1987, Kensington's predecessor obtained lease, well was spudded in 1992 during the primary term, and production ran from 1996 to 2001, when the well was shut in.
  - Kensington acquired the lease and resumed production from another formation, and made shut-in payments on the well.
  - B&G obtained a top lease, and filed an action claiming that the lease had terminated in 2001.
  - The habendum clause of the lease provides that the lease will stay in force "so long as the leased substances are produced", and Clause 3 states that if the delay rentals are paid, then the well is "deemed to be a producing well"
    - Clause 3 (the shut-in well clause) requires a shut-in payment to deem production at any time when a well is shut-in for more than 90 days
    - Proviso 3 allows for interruptions in production of no more than 90 days following the expiry of the primary term, but delays that are beyond the lessee's reasonable control shall not count towards the 90 days, nor will delays for any cause whatsoever which is in accordance with good oil field practice

- Trial judge held that the Lease had expired

- **Issue**
  - Did the shut-in provisions of the lease (i.e. subject to good oil field practice) allow the shut-in of the well in this situation?
- **Analysis**
  - Court says: resolve lease issues with recourse to each individual lease and its specific wording; read the contract as a whole to identify the parties' intentions
  - **Habendum:** The opening paragraph of the habendum clause provides that the lease will stay in force so long as the leased substances are produced.
    - Clause 3 states that if the delay rentals are paid, then the well is deemed to be a producing well.
      - As long as there is production or deemed production, the lease stays in force.
    - In this case, all the delay rentals were paid and the lease remained in force by reason of deemed production.
  - **What about proviso 3?** That proviso deals with a lease that has been extended by production and is then shut in.
    - This is a distinct provision that does not limit the actual shut-in clause (**does not add a limitation to the shut-in**, being that a shut-in is only permitted for one of the excuses that would allow for time not to accumulate towards the 90-day no-operations time)
      - The allowance for a 90-day period of no operations simply allows the lessee to suspend production for a period of 90 days where no valid excuses are present; beyond that period, the shut-in royalties must be paid
    - It is possible that a shut-in royalty is not even required in those certain circumstances that indicate that the 90-day period would not accumulate if there is an excuse, as allotted for in the proviso (as long as one of the excuses – good oilfield practices or circumstances outside the lessee's control is present)
  - Four reasons to not limit the Shut-in Clause with the "good oilfield practices" requirement
    - Proviso 3 is about stopping the clock only in limited circumstances
    - Shut in well clause allows for shut in only in discrete circumstances if the duration is longer than 90 days
    - Proviso 3 stated that the excuse of good oilfield practice for shut-in only applied in limited situations
    - No shut in royalty payment is required if proviso 3 states a condition that allows for a shut-in period not counting towards 90 days permissible period and that condition is met
- **Holding**
  - Appeal allowed; lease is valid and continuing because shut-in payments have been paid; The clauses of the lease must be read separately, so it did not matter whether Kensington had an excuse of circumstances beyond their control or good oilfield practices – those excuses are only necessary where there are no operations for longer than 90 days in a year AND no shut-in royalty payment has been paid
  - This is an unusual case because it's the first lease that has said you can technically have deemed production without paying a shut in royalty because of how the 2 clauses are construed.
- **Ratio**
  - If the lease allows for the payment of shut-in well payments that deem production to have occurred, then the lease will continue so long as those payments are made
- **Notes**
  - Facts
    - Challenge of bottom lease by top lessees
    - How does the proviso shut-in well operate?
      - Can only shut in if good oilfield practice
      - Will make the 90 day clock not run
    - How does clause 3 differ?
      - Is a standalone shut-in well clause that allows you to deem production via payment; it does **not** require good oilfield practice – you just need to pay
    - The issue becomes whether you read clause 3 as being influenced and limited by Proviso 3?
      - If you're the lessor, you'll be pissed about Clause 3; seems to give the lessee to deem production without many restrictions
  - Issue
    - How to properly reconcile Proviso 3 with the Shut-in Well Clause
    - Did the Shut-in Clause allow the shut-in in this situation?
    - Did the trial judge err in concluding that the Shut-in Well Clause could only continue the lease if shut-in occurs in accordance with "good oil field practices" as per Proviso 3?
  - Analysis
    - Resolve lease issues with recourse to each individual lease and its specific wording; read the contract as a whole to identify the parties' intentions
    - Three functions of this Shut-in Well Clause (p 226)
      - Will set circumstances under which shut in payment can be made
      - Specifies amount, which here is the delay rental
      - Functions to deem the shut in well a producing well pursuant to the requirements of the habendum
    - Two applications of Proviso 3 to 'stop the clock' (p 226)

        - At or after the expiry of the primary
        - It's a stand-alone function
    - Four reasons to not limit the Shut-in Clause with "good oilfield practices" requirement (p 227)
        - *See above*
    - Conclusion
        - This language is not enough to limit

5. Operations Conducted Under an Invalid Lease: The Geophysical Trespasser

Operations Under an Invalid Lease

- **Courts struggle with determining what is *just and equitable* in this situation**
- **Common problem: existence of a productive well suggests that the proceeds of production should have gone to the Lessor**
    - Well was productive when the lease was invalid – what do you do with the proceeds that were earned?
- **Conversely: if the Lessee is simply excluded from the land they may be leaving behind a fully functional oil and gas well (that they invested heavily in)**
- **Therefore, in crafting a remedy, upon what basis should damages be awarded?**
    - Finding the basis to justify this remedy is difficult
- **Damage awards based on actions framed in:**
    - **Unjust enrichment (early cases)**
        - Argued by the lessee
        - Operates a lot like estoppel in previous sections – where one party is forcing another party to deny lease validity (it's operating subconsciously)
    - **Breach of contract (always available)**
        - Argued by the lessor
    - **Trespass (*Sohio; Stewart Estate; Montreal Trust*) or Conversion (*Stewart Estate; Freyberg*) (since 2004)**
        - Argued by the lessor
        - Both actions are possible (***Stewart Estate***) but trespass appears more aligned with Canadian law and view that minerals are not under complete ownership until reduced to personal property when there is actual possession (prior to that point, there is only an exclusive right to work, subject to drainage from neighboring lands)
- **Damage awards that seek to:**
    - **Disgorge (fully or partially) – restitution gains-based rationale; or**
        - Disgorging lessee from profits
    - **Compensate – tortious compensatory rationale**
        - Compensating the lessor
    - The choice that is made will impact the damage award that is made

Champlin Refining Co v Aladdin Corp (Okla Sup Ct 1951) – Lessee as a Good Faith Trespasser Must Pay Damages of Net Proceeds of Production; Damages Based on Market Price at Time of Well Drilling, Not Highest Market Value Since Conversion; Plaintiff Did Not Commence Action with Reasonable Diligence

- **Facts**
    - Champlin Oil Company had leased land from state of OK. Both state and Champlin assumed the state owned the land and that Champlin could lease it. The land wasn't owned by state, it was owned by Aladdin.
    - Champlin enters on the land thinking it belongs to OK. Fact is that OK is like AB when it leases land, as it gives no warranty of title (i.e., take chances whether they own land or not).
    - Champlin drilled two wells on the land and started producing
    - Champlin then discovers that OK doesn't own the land in question – they were forced to give up the lease and the wells to Aladdin.
    - The lower court ordered Champlin to account to Aladdin for converted oil and gas at the highest market value between the conversion and trial.
        - Where does this measure of damages come from – the tort of conversion i.e., if using property and depriving of it during that period, the wrongdoer has taken away the opportunity to sell it at the highest price during that period
        - The court allowed Champlin to deduct processing expenses because Champlin had not acted egregiously.
    - Champlin appealed the basis of damages being set at the highest market price for the oil
- **Issue**
    - 1. Are the owners entitled to highest market value of the converted property as a result of the conversion/trespass?

- 2. Ability to offset proceeds with the costs of production incurred by the lessee?

- **Analysis**
  - It is a principle of conversion that a plaintiff may recover the highest value of the converted property if the asset has fluctuating value
    - **Caveat:** to take advantage of this, must commence and prosecute the action with **reasonable diligence**
  - Application here: **Not entitled to highest market value**
  - Record shows that **Ps failed to exercise reasonable diligence** in the prosecution of their action and are not entitled to the highest market value, especially given that Champlin was acting in good faith
    - 15 months unexplained delay in bringing action for wrongful conversion would preclude the owner from recovering highest market value
  - Champlin was a good faith trespasser, because they really thought they owned the land and paid money for the lease, therefore, they get treated leniently
    - They get to recover the costs of bringing well into production
  - It is still harsh that they have to disgorge net proceeds of production.
    - We usually only see this in the following categories:
      - (a) Breach of fiduciary duty
      - (b) Use of confidential information
      - (c) Breach of act restricting use of information (spy case) where there is a punitive element and deterrent factor so must give up everything
  - **Subconscious application of unjust enrichment:**
    - 1. Unofficious trespasser (innocent: thought they had the right to produce)
    - 2. Incontrovertible benefit (can't be denied: plaintiff is an oil company that would incur the cost of a well regardless)
  - Court uses justification for net proceeds from **Unjust Enrichment** – must give up what they got, but not more (lessor deserves net proceeds, but not gross proceeds and well head/equipment)
    - Unjust enrichment operates to fill a gap when there is no contractual solution
    - Unjust enrichment theory supports the logic that the lessee should receive their sunk costs back
    - This would appear to be a case where there is a deprivation, a corresponding enrichment, and a lack of juristic reason, suggesting that the lessor should not be benefited to the point of receiving all the benefits of the resource worked by the lessee

- **Holding**
  - Payment of net revenues ordered, but not at the highest market value (based on market value of oil when it was brought to the surface); Champlin is able to recover the costs of production (pays damages in the amount of net proceeds, not gross proceeds)

- **Ratio**
  - If subsurface substances have been converted, the plaintiff can only rely on the more generous calculation of damages (highest market value since the conversion) if they prosecute the case with reasonable diligence (prompt litigation or otherwise take immediate actions to mitigate the conversion).
  - When determining whether to set damages at the net proceeds or gross proceeds, net proceeds will be awarded if the trespasser was a good faith trespasser

- **Notes**
  - Recall OK is a unique place for oil and gas law
  - Facts
    - **State issues leases/licenses to Champlain, in error; Champlain voluntarily paid the proceeds as at the point of production**
    - Aladdin: This is our property; you've converted (taken our substance and marketed it)
    - ***Trial*: Champlain to forfeit the additional potential proceeds (highest market value), subtracting out the costs of production and also handed over the wells (with only partial compensation)**
  - Issues
    - 1. Are the owners entitled to highest market value of the converted property as a result of the conversion/trespass?
      - C was trying to recoup the capital costs they put on the property to get the site going, and when recouped forfeit any additional proceeds
      - Problem though: Aladdin wanted more than what C was voluntarily forfeiting – wanted whole proceeds to be benchmarked at the highest price during the time C was producing (not just the proceeds, but the extra bump)
      - In order to secure this remedy, the Ps has to demonstrate that they pursued their claim with **diligence** (upfront and continued their action expeditiously)
    - 2. Ability to offset proceeds with the costs of production incurred by the lessee?
      - Aladdin argued that there were certain costs that C shouldn't be able to discount
        - This included the drilling of an unprofitable branch on one of the wells
  - Appeal
    - Definition of conversion: Conversion is any distinct act or dominion wrongfully exerted over another's personal property in denial of or inconsistent with his rights therein

        - **It is a principle of conversion that a plaintiff may recover the highest value of the converted property when the converted asset has fluctuating value**
        - ***Caveat*: to take advantage of this, must commence and prosecute the action with *reasonable diligence***
        - **Here, not entitled to highest market value because the plaintiff failed to exercise reasonable diligence in prosecuting their action. This extraordinary remedy demands promptness. Also, Champlain acted in good faith**
            - There was a 15-month delay that was essentially not explained appropriately
            - Also, C acted in good faith and were willing to get rid of some of the earnings on this
        - ***Appellate court assesses damages as the marketed value subtracting out reasonable costs of production, including the non-productive diagonal well, drilled in good faith**
            - Cost of drilling unprofitable branch was part of the reasonable cost, and should be deducted on accounting
            - The court doesn't talk about UE, however…**Subconscious application of unjust enrichment:**
                - **1. Defendant an unofficious trespasser (essentially innocent: Lessee thought they had the right to produce).** Mistake was made by the State
                - **2. Plaintiff receives an incontrovertible benefit (can't be denied: plaintiff is an oil company that would incur the cost of a well regardless)**
    - **Do mines and mineral cases fit neatly with traditional conversion cases?**
        - If utilizing compensation principles associated with conversion, first thing is to show that you have personal property
        - It would be different if M&M owner had already stored the oil in storage tanks, that would undoubtedly be personal property for conversion and should get the highest market value
        - In a Canadian context, probably more easily reconciled with trespass – it's more about the party being on land when they don't have a legal justification to being there?
    - **How would we explain this given Canadian oil and gas ownership theory?**
        - Recall: *in situ* ownership exists as a bundle of rights; oil and gas not personal property until reduced to actual possession at the surface
            - You don't perfect ownership until it's reduced to possession
            - Has Aladdin reduced these to possession? No

Historical and Contemporary Issues

- **Historically, these issues arose because of imprecise surveying leading to inappropriate extraction**
- **Contemporarily, these issues occur:**
    - **1. Because of an *error in title***
        - E.g.
            - Typographical error – error in title description
            - Error via the transactions
    - **2. Operations/production by a Lessee under a lease that the *Lessee mistakenly believes to be valid***
        - E.g. Lessee thinks they did everything right to go from primary to secondary term; but then a few months later the lessor says they didn't and that the lease is valid (leads to months of production being called into question)
- **From 2004 onwards, the trend seemed to focus *less on unjust enrichment* and more on *simple torts damages for trespass*, as informed by equity**
    - Trying to take into account the behaviour of the parties
- ***Stewart Estate* (2015, ABCA) makes it clear that trespass/conversion are applicable to mines and minerals cases**
    - On an Exam: Note that both are therefore available
- **Unfortunately, this does not mean that there is certainty in the application of the mechanism for assessing damages**
    - Something the Court still struggles with

Sohio Petroleum Co v Weyburn Security Co (1971 SCC) – Plaintiff Landowner vs Good Faith Trespasser Without Lease; Trespasser Keeps Proceeds Up Until Date That Statement of Claim Filed; Landowner Received Net Proceeds After that Date; Just and Equitable Remedy

- **Facts**
    - Essentially a ***Kininmonth*** problem - construction on the well started during the primary term, was completed outside of the primary term, and was therefore invalid because the lease required production at the termination date to extend the lease.
    - The problem is that the well was very successful and produced for 12 years
    - The Lessor was not estopped from denying the validity of the lease.

        - So, **lease termination + lessor *not* estopped from denying lease validity**
- **Issue**
    - What damages are warranted?
        - What to do with the period of production and the money that was gained during that period of time?
- **Decision**
    - **Seems to deal with the accounting/damages issue with the then emerging principle of unjust enrichment**
    - **The court selected a moment in time [here, moment writ of summons served**/statement of claim served/notification of the action being commenced**] that roughly approximated when the money the Lessee made from production exceeded the capital costs that were expended to achieve production**
        - "The court has jurisdiction to grant this relief on terms which will be just and equitable to all parties involved. The appellants were first aware that their position was challenged when the writ of summons was served upon them. At that time the revenue which they had received from the sale of the production exceeded the amount they had expended."
        - So, after the lessee was served with the writ that challenged the lease, the lessor received the net proceeds; anything before this moment proceeds-wise goes to the lessee
        - Thus, Sohio (the trespasser) gets to keep all of the proceeds of production up to when the statement of claim was served on them. Weyburn is entitled to receive net proceeds for all oil produced since the statement of claim was served on Sohio
    - **Lessor received 30% of net proceeds; restitution**
- **Notes**
    - **And, thus, the quest for a *just and equitable* remedy begins…**
        - The SCC is basically citing a pretty ambiguous CA decision, thus becoming an imperfect precedent
        - This case is similar to ***Borys***, in that does an okay job of articulating first principles from which we see subsequent application (an uncomfortable precedent)

Montreal Trust Co v Williston Wildcatters **(2004 SKCA) – 3 Rules from *Livingstone*; Innocent Trespasser for 2 Years; Damages to Lessor Based on What Would have Been Received from Another Lessee; Better Royalty and Bonuses; Milder Rule (Mild Rule #2); Trespass**

- **Facts**
    - Following the end of the primary term, the lease could be continued for so long as there was production or "drilling or working operations"
    - Well produced from 1955-1990, when production ceased for 7 months.
    - During that time, the lessee plowed snow to access the well site, the field operator attended the well to thaw it out, a fence was built around it, and the lessee paid the surface lease rent and taxes.
    - A court found that the lease lapsed in 1990.
    - The lessee continued to construct another well and produce from it until 2001.
    - The SKCA later found that the lessee operated with the leave and license (express permission) of the lessor from 1992 to 2001 - but this still leaves two years where oil was produced without a valid lease.
    - Appellant (Montreal trust) claimed full compensation for the value of its minerals less the costs of production and marketing so that the respondent would not profit from its trespass
    - Trial judge awarded compensatory damages, calculated on the basis of a higher royalty plus a signing bonus (which is presumed to have been the most the appellant would have received by leasing the land to someone else during the period when the lessee was trespassing).
- **Issue**
    - How should damages be assessed?
- **Analysis**
    - **Main objective in awarding a plaintiff damages (compensation)**:
        - To put that plaintiff in the same position it would have been in had the wrong not occurred
    - **Restitutionary damages concentrate on the wrongful benefit to the defendant, not the loss to the plaintiff.**
        - This is often used if the defendant has not caused any physical damage to the plaintiff but has still wrongfully profited from his trespass.
        - These damages may also be conferred in cases of a mistake.
        - In this case, the defendant mistakenly believed that they were authorized to develop the substances.
    - **Trespass/Conversion Rules for Damages:**
        - **The "harsh" rule in restitutionary damages (full disgorgement):**
            - Not allowing a deduction of damages for production costs (damages based on gross proceeds)
                - This is used where the defendant knew that they were committing a wrong (not the case here).
            - In this case, to order the lessee to pay damages in the amount requested would result in a large windfall profit to the appellant
        - **The "mild" rule:** where the trespass is not tainted by fraud or bad faith, the punitive element is removed; Options are:

- 1) Partial disgorgement (restitutionary)
    - Used where an innocent trespass has occurred - damages are the market value minus all reasonable costs.
- 2) Royalty (compensatory) – the milder rule
    - The best evidence of loss is the royalty payment that the plaintiff would have received from a new lessee
    - That is what applies in this case - the plaintiff is entitled to the amount they would have made from a royalty (making reference to similar royalties paid on adjacent lands), with costs deducted.
        - The Bank of Montreal is a bank, not an oil company - therefore, to give them all profits would be a massive overcompensation because they realistically could only ever obtain a royalty payment.

- **What if Wildcatters was a bad faith trespasser?**
    - They would have been forced to give up at least the net proceeds of production, and perhaps the gross proceeds.
    - The claimant would be overcompensated, but the overcompensation would be justified as a result of the wrongdoing.

- **Holding**
    - Appeal dismissed; the lessor did not net proceeds of production from the lessee during the time of "trespass", instead they received damages in the amount of a predicted bonus and higher royalty payment that they would have received from another lessee during that period
- **Ratio**
    - The "harsh" rule will be used to calculate damages if the trespasser knew it was committing a wrong, while the "mild" rule will be used if the trespasser was innocent. The mild rule seeks to return the aggrieved party to the state that they would have been in had the trespass not occurred.
- **Notes**
    - Facts
        - Get a gap from Jan 1990-March 1992 where the lessee wasn't validly producing
        - On damages:
            - The appellant contends that the trial judge erred in assessing damages on a compensatory rather than a restitutionary basis as a result of the continuing trespass by the respondents. The appellant claims full compensation for the value of its minerals less the costs of production and marketing so that the respondent would not profit from its trespass. In its submission the trial judge erred in awarding only compensatory damages which are calculated on the basis of a higher royalty plus a signing bonus.
                - Lessor: Don't let the lessee benefit at all
            - Lessee: Look at the lessor, they don't have the ability to produce the land in a way we could. So, we should just compensate them in a way they would have received
    - **Damages: at Trial, Lessor awarded a royalty + bonus**
        - General damages theory (p. 223)
        - Compensation v. Restitution
        - The logic of *Livingstone*: to put the plaintiff in the position they would have been but for; "hasher and milder rules"
    - **Trespass/Conversion Rules (equitable flexibility):**
        - 1. *Harsh Rule* (full disgorgement)
        - 2. *Mild Rule* – 2 variations
            - Partial disgorgement *or*
            - Royalty (compensatory) – "milder" rule
    - **Progression of English cases (p. 233-234):**
        - ***Martin v Porter*** – willful trespass + coal extraction – "harsh rule" with deduction only for cost of transporting coal to the mouth of the mine pit
            - D was purposely on the land extracting coal when they weren't allowed to be there
            - Harsh rule – full disgorgement of any of the profits that were gained by extracting/marketing. The only deduction was the cost of transporting that coal from in the mine to the mouth of the mining pit
        - ***Wood v Morewood*** – mistaken belief + coal extraction – "mild rule" in partial disgorgement without lessee profit (market value minus cost of mining and carrying to surface)
            - Mistaken belief regarding coal extraction
            - Court: They thought they could extract, so we should use the mild rule – partial disgorgement with the objective being the lessee not actually profiting. They don't profit, and there's no punitive hut
        - Both the "harsh" and "mild" approaches are flexible:

- ***Morgan v Powell*** – D had outrageous conduct… no transport deduction in application of "harsh" rule from *Martin*
    - No deductions are allowed at all
- ***Livingstone*** – "milder"/mild rule #2 rule: landowner only receives royalty; does not want the plaintiff to benefit from a windfall (p. 234)
    - All of a sudden, we get a switch: Before, it was on the miners/Ds were acting. In this case, the court changes its perspective and focuses on what the P normally would receive. Here, the P would expect to get a royalty; to give them more than that would be to give them a windfall, and we don't want to do that
        - *CJ: Is this a good idea though? One of the arguments you could make is that you're devaluing what these property rights should mean in our society*

- **English jurisprudence worked its way into Canadian natural resource extraction disputes in *Shewish v. MacMillan Bloedel Ltd.* (p. 235)**
- **Parties agreed that *Sohio* governed resolution of the dispute. But, does this mean that:**
    - Restitutionary-style damages *must* be awarded?
        - That we divide it out at a moment in time?
    - That the *operative date* is the moment in time that the Lessee is made aware that the lease may be invalid?
        - What if it's something that can be litigated on both sides?
    - Did not expressly endorse any "harsh" or "mild" approach
        - Analysis guided by the "just and equitable" result
- *What you need to do*: **Look to the facts and apply the law, as appropriate, within the "harsh" + "mild" framework. In this case:**
    - 1) *Harsh* – to deter willful trespass – full disgorgement of proceeds (minus transport costs, probably) [restitution]
        - Trying to deter future willful trespass (focusing on the action of the D)
    - 2) *Mild (#1)* – punitive element removed and the trespasser "breaks even" and plaintiff receives what they would have had they extracted and sold the resource [restitution]
        - Partial disgorgement within a restitutionary framework
    - **3) *Mild (#2)*** – when the plaintiff could not work the product themselves, they won't get a "bump". Royalty only [compensatory] – applied here at top of p 238
        - You focus on the Ps
        - Limited to a royalty and maybe a bonus payment
- Appellate court focuses on the fact that the plaintiff did not have the ability to produce the oil themselves
- Trial judge based the damages award on the basis of what the lessor could have reasonably expected with a valid lease in place—a royalty + bonus
- Relevant considerations: Factors a-f in case led to Mild #2 applying:
    - a) The appellant could not have drilled the well itself and the only way it could have received revenue from the property was to lease it to a third party;
    - b) In 1990, there were no great prospects for the NW 8-4-33-W1st and that the unitholders of the appellant were not interested in undertaking the risk of drilling on the property;
    - c) Even after an issue arose concerning the validity of the lease, the unitholders wanted production to continue with a 12.5% lease in place and requested that a pump be installed in 1997 to enhance production.
    - d) The maximum royalty under a petroleum natural gas lease that the appellant could have obtained was 18%. Mr. Hughes and Mr. Raymond (unitholders) leased an adjoining quarter for an 18% royalty and they were prepared to accept the royalty of 16% even after the 11-8 well had been producing for a year.
    - e) The appellant at no time requested the respondents vacate the property. They were content to have production continue and to receive royalties.
    - f) There was no bad faith or mala fides on the part of the respondents. All parties were operating under a mutual mistake as to their respective rights
- For the gap, damages therefore get awarded based on the royalty expected, and any signing bonus they would've gotten for covering the gap
    - So, you see ***Livingstone*** carry the day
- Does this approach seem workable and appropriate?
    - Yes

Freyberg v Fletcher Challenge Oil **(2007 ABQB) – Compensatory Approach; Damages to Lessor Based on What Would have Been Received from Another Lessee; Mild #2; Likely Royalty and Bonuses Negotiated; From the Date of Serving Notice**

- **Facts**
  - Lady Freyberg inherited 2/3 interest in a mineral title to certain lands in AB, and a well was drilled in 1979. Despite positive test results, the lessee decided to shut-in the well for a period of 21 years, citing a lack of market and they were paying SIRs so they were within their rights.
  - The shut-in well clause was limited and said you can shut in only as a result of lack of economical/profitable market.
  - When the well was finally put to production (1999) the plaintiff's well-head had the highest level of production in the field.
  - In reality, the lessee only had a 25.83% interest in that well, and they had another well in the field with a 51.66% interest. Therefore, the lessee could increase their return by increasing production from one of the other wells in which they had a greater interest (acting in their own economic interest)
  - Lady Freyberg sued the lessee, arguing that the lease had terminated at the latest of 1987 because there had been no good reason not to produce in the face of the market and economic conditions at the time
    - Sued in conversion
  - Trial judge denied her request and she appealed that decision
- **Issue**
  - What damages can Lady Freyberg receive for failure of lessor to produce, which caused the lease to expire while the lessor remained on the land as an innocent trespasser?
- **Analysis**
  - **There are two approaches for determining the measure of damages awarded in cases of conversion:**
    - **Restitutionary** (removing the benefit gained by the wrongdoer from the trespass) and
    - **Compensatory** (focuses on putting the plaintiff back in the position they would have been in had the tort not been committed).
      - The compensatory approach may be similar to the "mild" form of restitutionary damages (the cost of the substance converted minus costs of production).
  - **Restitutionary damages (harsh and mild rule – focusing on the lessee's profit)**
    - Based on the theory that the wrongdoer should not profit from his wrong.
    - There is a distinction between "mild" and "harsh" forms, depends on whether the defendant knowingly committed a wrong, or was acting bona fide.
    - In order to take the "restitutionary" approach (which could lead to overcompensation to Freyberg), the court must find:
      - That the defendant's conduct was sufficient reprehensible to warrant ignoring the potential overcompensation to Freyberg.
        - There is no justification for that in this case.
        - The defendant's conduct during the litigation process was based on their bona fide belief that the lease was still valid - no intentional malice in their actions.
  - **Compensatory approach (milder rule – focuses on the lessor's loss)**
    - For the compensatory approach, if the applicant can show that they would have been **able to exploit the substances themselves were it not for the trespass**, they would be entitled to the value of the substances converted, less the cost of production (equivalent to the "mild" rule under the "restitutionary" approach).
    - **However, if the applicant is not capable of exploiting the substances themselves:**
      - Then the amount will be calculated on the basis of the royalties and bonuses that they could have reasonably expected to make had they contracted with another party to exploit the substances.
    - In this case, the compensatory approach is preferable.
  - **Damages from date the notice is served on the defendants**
    - In ***Sohio***, the Court found that the applicant will be entitled to damages for substances produced from the date that notice is served on the defendants.
      - In this case, notice was served in 1999 on the defendants that Freyberg intended to challenge the validity of the lease.
    - Therefore, to determine the appropriate level of damages, must look objectively at what royalty rate the parties would likely have agreed to back in 1999.
      - Had the well been producing as it should have been, Freyberg would not have accepted a 15% industry standard royalty in 1999.
        - That level factors in the inherent risk of the well not being a producing well - that was not in question in 1999, everyone knew that the well was outstanding.
      - Freyberg therefore had significant bargaining power in 1999 to negotiate a high royalty rate (could be as high as 30%-45%)
- **Holding**
  - No question that the Oil Company Defendants took Lady Freyberg's gas and have therefore committed the tort of conversion; compensatory damages measured in the amount of royalty and bonuses that would have been negotiated with another lessee at the date that Freyberg provided notice (in the form of a statement of claim) to the lessee
- **Ratio**

- In calculating damages on the compensatory basis, must look at whether the applicant could have produced the substances themselves, or would require a lessee to do so.
    - If the latter, calculate the value of the royalty and bonuses that they would have received from the date that notice was served on the lessee based on an objective assessment of what the parties would have agreed to as a royalty rate.
    - For a well that is known to be high producing, the royalty rate will be much higher than for one that has not been drilled yet, as the same risk component is no longer present

- **Notes**
    - Application of the same approach as ***Montreal Trust Co***
    - What cause of action?
        - Damages from conversion NOT trespass (p. 239) – *Interesting flip flop*
    - Court bases its reasoning on compensation [Lessor focused] rather than restitution [Lessee focused]
        - Even though there was some strange conduct on behalf of the lessee, the court focuses on the lessor
    - Freyberg tries to distinguish ***Montreal Trust***, but isn't successful. Why?
        - Tried to say that "I'm in a position unlike a trust company where I should be able to help development be realized individually"
            - Court: There are too many institutional barriers to Lady Freyberg operating this well herself either personally or through a corporation, even with an experienced contract operator to do the work.
    - On what basis does the court ultimately base its damages award?
        - Compensatory approach – royalty + bonus
    - Interesting "negotiation" considered by the court (pp. 239-240) – what agreement could these parties have reached?
        - "In my view the appropriate question to ask is had both sides known conclusively in December, 1999 that the lease was not valid, as reasonable parties and in the case of the Oil Company Defendants who are public companies, under a duty to maximize value for the shareholders, knowing that it was economic to produce the well at that time, what agreement would they reach? Lady Freyberg would not have accepted a 15% royalty and a bonus. Neither would she have accepted a slightly increased royalty and bonus. She would walk into that negotiation knowing that she owned the gas and arguing that the EUB could resolve the problems dealing with NV Resources and ownership of the well license and surface lease and also the slight possibility that she could 'go it alone'. She also would be able to argue that if the Oil Company Defendants produced over her objections, a hearing on her damages just like this one would follow. At that time, neither side would know what the decision of the Court would be. Would the Court follow the cases dealing with conversion of natural resources and would it choose the mild or the harsh rule? Although the outcome is now known, it would not have been at that time. Williston had not been decided. She had significant bargaining power.
        - The Oil Company Defendants would walk into the room with the well license, the surface lease and the support of NV Resources. The defendants could not argue that Lady Freyberg would be only entitled to the industry standard royalty amount because that amount takes into account the risk in oil exploration and recovery."

Stewart Estate v TAQA North Ltd (2015 ABCA) – Net Proceeds Disgorgement Appropriate for Innocent Trespassing by Lessee After Lease Becomes Invalid; Rowbotham Points to Issues in Mild Rule #2 and Harsh Rule; Date After Net Proceeds Are Provided Depends on the Facts of the Case; Key Case

- **Facts**
    - 5 freehold petroleum and natural gas leases were executed in the 1960s; each lease contained a 10-year primary term and habendum clauses allowed the leases to remain in force as long as production continued.
    - If production ceased and was not restarted within 90 days, the leases would terminate.
    - A "third proviso" in the leases stated that if production ceased due to the "lack of or intermittent market" or reasons "beyond the lessee's reasonable control", the cessation in production would not count towards the 90-day termination period.
        - In 1995, production ceases on all five leasehold properties and did not restart until early 2001.
    - Rowbotham JA held that that the leases had terminated in 2000, as 2000 was the first year in which it was economically profitable to resume production on the leased sites *(90 day clock starts ticking)*.
        - Given that production was not resumed within 90 days, the leases terminated as per the terms of the agreements.
        - **Test applied by Rowbotham:** Relevant test is whether, based on information available at the time, a prudent lessee would have foreseen profitability from the wells in question.
            - Once profitability became reasonably foreseeable, the Respondents had 90 days to resume working operations
        - Rowbotham JA allowed the Appellant lessors a **right of action under both trespass and conversion**
    - McDonald JA and O'Farrell JA found that all five leases terminated in 1995.

        - Under the terms of the lease, the third proviso could apply only if production was "interrupted" or "suspended" due to a lack of or intermittent market.
            - In this case, the Respondents deemed that production from the well would not be commercially viable (for themselves) for the following five years and completely ceased production.
                - However, surrounding gas fields continued to produce and sell.
                - Thus, the reason for the cessation in production was the well's lack of economic viability (lessee's conduct), not the lack of or an intermittent market (so proviso 3 was not applicable and the lease terminated)

- **Decision on Damages**
    - Royalty approach to damages rejected; harsh rule rejected;
    - Mild rule to disgorgement ordered for lessee to pay the net revenues from the well, from the date the lease
- **Reasons (Rowbotham JA):**
    - **Continuum of remedies for trespass after a valid lease terminates**
        - 1) Trespasser's conduct warrants punishment (restitution damages)
            - Harsh rule: lessee required to disgorge the entirety of the benefit gained from the trespass with little or no allowance for costs incurred in earning that benefit or improvements made to the property.
        - 2) When the trespass is not tainted by fraud or bad faith
            - A) "Mild" rule (still restitution):
                - Requires the trespasser to disgorge the revenues less certain expenses, but with no allowance for profit to the trespasser (***Sohio***)
            - B) "Royalty method" (compensatory):
                - When neither party knew of the trespass and the property owner would have been unable to realize the benefit the trespasser obtained from the trespass:
                    - Trespasser retains the benefit of the trespass and is ordered to pay the property owner a reasonable fee for the use of the property (on basis of royalty and bonuses that would have been negotiated) (***Freyberg; Montreal Trust***)
    - **Rowbotham begins by looking to the principles of *Sohio v Weyburn***
        - The SCC in ***Sohio*** looked to find an equitable and just remedy for the factual circumstances
    - **Problems with the royalty method:**
        - Allows the lessee to benefit from the resources that they have no legal title to
            - Tortfeasor without title will generally be in exactly the same position as a lessee with title
        - Requires the court to speculate on a lessor's intentions and punishes the lessor for being unable to extract the oil and gas resources themselves
    - **Harsh rule:**
        - With respect to the Harsh Rule, argues that ***Sohio*** allowed for something less than 100% disgorgement (recall: 30% of net proceeds)
            - Questions the availability of the Harsh Rule in cases of this nature, arguing that such punitive sanction from the court requires the existence of "malicious, oppressive and high-handed misconduct that offends the Court's sense of decency, or is extreme [and] deserving of full condemnation and punishment
        - Disgorgement of revenue with no set-off for expenses incurred in earning that revenue (the harsh rule) should no longer be available to remedy a trespass of this nature
            - This <u>outcome should only be permitted in extraordinary circumstances</u>
        - The harsh rule is punitive and should be abandoned unless the trespasser's conduct warrants punitive damages
    - **Mild rule:**
        - The correct response when there is no conduct warranting punishment carried out by the lessee; even wrongdoing fiduciaries may be entitled to an allowance for their special skills, expertise and effort
        - Starting point for calculation is: "net operating income" [net proceeds]
            - Proceeds minus the reasonable costs of production, transport and marketing
    - **Date after net proceeds provided:** Will depend on the facts of the case (here it was 2003, even though the lease became invalid in 2000; in ***Sohio***, the date was the day on which the action was commenced by the lessor, which coincided with the point where the lessor was able to recover their costs)
- **Ratio**
    - The mild rule of requiring the trespassing lessee to disgorge their revenues less certain expenses (pay net revenues) to the lessor is the correct approach to damages, unless the lessee engages in conduct warranting punishment (then engage the harsh rule; rare)
    - **Action can be made by the lessor in either trespass or conversion (trespass better fits with Canadian oil and gas law)**
    - Date after which net proceeds will be provided to the lessor: Depends on what is fair and equitable in allowing the lessee to cover their costs, but should generally be the date of lease invalidity
- **Notes**
    - End up with a judgment that doesn't really settle lease issues ideally
    - Facts
        - Contest to 5 freehold leases

        - Each habendum allowed for lease to continue so long as production continued
        - Production ceases in 1995, and doesn't start again till 2001
            - Lessee – production during that break wouldn't have been profitable, and that they were validly shut in in accordance with proviso 3
            - Lessor – at some point during that period, it was profitable, and it wasn't okay for the lessees to shut-in
    - Issue
        - Lease termination – 1995, 2000, or not at all?
        - Cause(s) of action – trespass, conversion, or unjust enrichment?
            - Recall: **If an issue like this arose in 2020, what would you bring?**
                - Trespass for sure
                - Conversion probably – a bit more tenuous
                - UE not likely to be a winner
    - Damage assessment approach
        - Trial: mild compensatory approach to damages of Royalty + bonus
            - This is what we saw in *Wildcatters* and *Freyberg*
            - Says that: For the relevant period of time, what could the lessor have reasonably been expected?
            - To award more to the P would be an unjustifiable bump
    - McDonald and O'Farrell
        - Leases terminated in 1995
            - When initial decision to shut in wells was made
            - This went beyond a normal shut in – the lessee's abandoned the wells (equipment was removed)
        - 5 year shut-in based on decision of individual well's economic viability rather than market conditions; these actions amounted to well abandonment
        - This terminated the lease and rendered Proviso 3 inapplicable
            - In the situation of abandonment, proviso 3 is inapplicable
    - Rowbotham – very compelling
        - Lease termination in 2000 on application of the *Freyberg* market test; Lessors could proceed by trespass or conversion
            - Comes to this conclusion from profitability test: The relevant test is whether, based on information available at the time, a **prudent lessee would have foreseen profitability from the wells in question**
        - Her analysis allows for bringing something in both trespass and conversion
        - Her remedy analysis starts with *Sohio* – "just and equitable". We have these different approaches
            - Harsh rule – full disgorgement (very minimal deductions allowed by the lessee). To its full extent, the goal is to deter willful trespasses from occurring
            - Mild rule
                - Mild rule 1 – innocent trespasser → partial disgorgement. Award is value of production minus cost of severance production and marketing (lessee can recoup some costs). You will have a lessee that doesn't make profits, but they also don't incur costs
                - Mild rule #2/Milder rule – focus on the lessor → compensatory. Could they have produced it themselves? If not, all they're going to get is a royalty plus bonus
        - Observes that the compensatory Royalty + bonus approach ignores resource ownership and might encourage a lessee to continue production under a lease that has been challenged because consequences not severe
            - We don't have to conclude that the mild #2 rule approach is the best recourse. Partial disgorgement might be the better approach
            - There is likely something the lessors can get beyond a bump in their royalty
            - If all we do is award a better royalty, what we're doing is sending the signal that lessees don't have to be that cautious – it just results in consequences that aren't that severe. Does this really respect the property right of the landowner being accounted for and respected?
            - Discounts the lessor's character (i.e., ability to exploit resource), suggesting that this underemphasizes property ownership. This approach requires the court to speculate on a lessor's intentions and punishes the lessor for being unable to extract the oil and gas resources themselves
        - With respect to the Harsh Rule, argues that ***Sohio*** allowed for something less than 100% disgorgement (recall: 30% of <u>net proceeds</u>)
        - Questions the availability of the Harsh Rule in cases of this nature, arguing that such punitive sanction from the court requires the existence of "malicious, oppressive and high-handed misconduct that offends the Court's sense of decency, or is extreme [and] deserving of full condemnation and punishment"
            - If we're going to apply this rule, it should be limited to situations where there's serious misconduct
            - CJ: This makes sense. The harsh rule is something that goes to an extreme

- The harsh rule goes too far, and the mild #2 rule doesn't go far enough; this is why the mild #1 rule makes the most sense in this context
    - Concludes that the mild restitutionary approach is correct in the circumstances. This is implicit in ***Sohio***
    - Starting point for calculation is: "net operating income" [net proceeds], which is to say *proceeds minus the reasonable costs of production, transport and marketing for the minerals that were wrongfully worked*
        - We look for the proceeds when the lease was invalidated less the reasonable costs of production, transportation, and marketing for the minerals that were wrongly worked
- **Tortured application of *Sohio*** – conflicting view that leaves the court in an unsettled position
    - **Rowbotham**
        - "On my reading of *Sohio*, although the courts did not refer to it as such, the result upheld by the Supreme Court reflects the mild rule." Also, "I conclude that neither the royalty approach nor harsh rule are consonant with *Sohio.*"
    - **MacDonald**
        - "In my view, by no stretch of the imagination could it be said the lessees were acting in good faith when they re-commissioned the well in 2001, and as such should be subject to exactly the remedy that was upheld by the Supreme Court of Canada in *Sohio*. The decision in *Sohio* may not be extensive but it is binding on this court." [Then proceeds to endorse the Harsh Rule]
    - **O'Farrell**
        - "In *Sohio*, where production had been wrongly taken following a petroleum and natural gas lease which had expired, the Supreme Court of Canada adopted a ruling by the Saskatchewan Court of Appeal that the lessees 'account for all benefits from production received by them after the date of service of the writ of summons upon them'. I would propose to follow that prescription in this case; although it should be made clear that the appropriate measure of damages for wrongful production following the termination of a natural gas lease may vary with circumstances. I articulate no general principles here." [Ultimately, endorsed Rowbotham's approach to damages]
- Takeaway: Room for argument depends on where the case is brought
    - If brought in AB, the outcome may be different than what may happen in SK
    - This case was in AB
- While Rowbotham gives us a useful analysis (that is somewhat restitutionary), her analysis arguably **makes that approach properly compensatory**
    - We're compensating for the property right impacted, and this approach effectively does that due to the unique nature of o/g → line blurred between compensatory and restitutionary in her reasoning

Xerex Exploration v Petro-Canada (2005 ABCA) – Compensatory Damages Approach; Putting Wronged Party Back Where They Would Have Been; Xerex Would Have Entered 50/50 Farmout Instead of 3% GOR Had They Not Been Misled

- **Facts**
    - Abt is the sole shareholder of Xerex. Petro-Canada owned "shallow rights" and Xerex owned "deep rights" under the Petro-Canada formation.
    - Abt discovered that Progress Energy was producing oil from a well that Xerex owned a 3% gross overriding royalty in; Xerex had never received any royalty money from that well.
        - Xerex had formerly held a full license to drill the well, but then sold it to Petro-Canada in exchange for the gross overriding royalty.
        - What Abt did not know was that Petro-Canada had already drilled a well into Xerex's deep formation and knew how profitable it would be (Petro-Canada kept the information hidden from Xerex in their negotiations)
        - When Petro-Canada purchased the license from Xerex, it did so at a lower price than Xerex would have been willing to sell it for had Xerex known how lucrative the site was.
    - Lower court found Petro-Canada liable in trespass, conversion and misrepresentation
        - He awarded Xerex $8,133,000 in damages for the misrepresentation
- **Issue**
    - Did Petro-Canada have a duty to disclose its findings regarding the quality of the well to Abt when it purchased the full license? What damages should be awarded?
- **Analysis**
    - **Fiduciary relationship:**
        - Particular circumstances of this case put Petro-Canada in the position of a fiduciary
            - Trespass and gain of knowledge of the deep rights placed Xerex in an extremely vulnerable position given that is was the party with the exclusive right to explore and exploit the Deep Rights
            - this imposed a duty to disclose findings to Abt and Xerex
        - **Petro-Canada had a duty to disclose to Xerex:**
            - (a) That it had entered the Deep Rights, and, if asked,

        - (b) What it discovered when it did so.
    - **Trespass on a profit a prendre**
        - Xerex's license provided it the "exclusive right to drill for, win, work and recover"
        - It is possible to trespass on a profit à prendre
        - Tort of conversion deals with interference to goods and chattels, rather than land
            - Court did not rule on whether there could be conversion in association with materials under a profit a prendre not yet reduced to possession
    - **Misrepresentations**
        - Petro-Canada made **false representations** that it had not explored Xerex's formation during the course of negotiations, even though they knew that they had done so.
            - This constitutes a material misrepresentation in the course of negotiations.
    - Xerex argues that, because the license was transferred to Petro-Canada due to misrepresentation, it continued to hold the **equitable title to the lease**, notwithstanding that legal title passed to Petro-Canada
        - Therefore, the damages should reflect the amount that would be restored to Xerex if the property was returned
            - **Xerex would have negotiated a 50% farm out arrangement if it had known the quality of the well (it would not have retained a 100% interest).**
                - Therefore, the trial judge found that Xerex is entitled to 50% of the value of the mineral interest as of the date of trial, which is approximately $8 million.
        - **This is the appropriate way to calculate damages:**
            - Xerex would not have agreed to retain only a 3% overriding royalty if it had known the extent of the reserves under its license.
                - But Xerex would also not have developed the well itself, because it only had 13 days remaining on its license
                - The damages must flow from the misrepresentation
            - This is a good example of how the disgorgement principle applies.
    - **Note on gross overriding royalties**
        - Gross overriding royalties:
            - Occurs where the lessee sells its mineral rights to another lessee, but retains a royalty (being a gross overriding royalty – this attaches the lease, rather than to the mineral estate)
            - A royalty attaches to the mineral estate comparatively
- **Holding**
    - Appeal dismissed; Xerex was awarded 50 percent of the $16.2 million
    - There was trespass, misrepresentation and breach of fiduciary duty (conversion was not found, as there was an issue with the resource not yet being personalty)
- **Ratio**
    - In cases where one party makes a material misrepresentation to the other that induces the other party to sell its interest when it otherwise would not, the wronged party is entitled to all of the profits it would have received had it not sold the interest.
    - In effect, the wronged party continues to hold equitable title in the property, notwithstanding the fact that legal title has been transferred
- **Notes**
    - Facts
        - Xerex felt swindled
        - Argues that is his GOR interest was insufficient
            - GOR: Gets 3% of the proceeds of the well; gross not net; becomes overriding royalty as opposed to a first-instance royalty since it's been carved out of the lessee's interest
                - Lessor holds a royalty, Lessee holds the remainder; lessee can carve out of the remainder of their proceeds a royalty to give to other parties
                - **It is a right to receive revenue in a manner that's unconnected to the mineral ownership** (it's not coming out of the lessor's interest)
    - What claims can they bring?
    - Issues
        - Misrepresentation? (See conversation @ p.245)
        - Special relationship/Breach of confidence? (p. 248)
        - Trespass/Conversion? (p. 249)
    - Trial – found liability on trespass, conversion + misrepresentation (by silence)
    - Damages – compensatory in scope and founded primarily upon the misrepresentation (p. 250)
    - **CA uphold liability on trespass/conversion and misrepresentation, but add that the misrepresentation was an actual misrepresentation (not on silence)**
        - What's the misrepresentation?
            - X has this license interest to drill into a deep mineral reserve, which was going to expire in 13 days. Petro wanted to capitalize on this. Petro held the shallow interest. Petro approaches X and says you

have 13 days, we're willing to work with you and give you a GOR if you transfer your interest in the land to us since we're onsite ready to drill. This negotiation is then recorded
        - Apt (X) wanted to know if Petro had already drilled into it, and they said **no.** On the basis of the exchange though, X agrees to the 3%. The facts play out though that Petro **had drilled into the deep reservoir** and logged data.
        - X was in a disadvantaged position, and Petro was misrepresenting
        - CA: This was more than incomplete disclosure, it was misleading
    - Agrees with TJ on what the appropriate resolution should be
        - It wouldn't have been a 3% GOR, it would've been a 50-50 farmout arrangement. They knew there was profitability there, but X wasn't in a position to get there within 13 days (before lease expired). Petro was in a position to get there, so X could have negotiated a farmout arrangement

International Corona Resources Ltd v Lac Minerals Ltd **(1986 Ont; 1989 SCC) – Mistaken Improvements of Land; Lease Invalid by Way of Misappropriated Information; True Owner Must Pay Lessee Back for Improvements That Would Have Been Made Anyways**

- **Facts**
    - Corona obtained ability to start gold mine on plot of land; significant upfront cost. Brought in established gold mining company (Lac) to help them get running. Lac helped with infrastructure, processes; became aware that Corona knew gold in mine extended onto neighbour's property (owned by Williams) and that Corona was planning to try to develop mine on Williams property. Lac swooped in and outbid Corona for the right to develop that land
    - Corona initiated lawsuit for transfer of title. Claimed breach of fiduciary relationship because of info held due to relationship between parties
    - Lac claims it spent $203M developing Williams' property in meantime; wants to be compensated by Corona. Corona contends that it is not required to compensate Lac for any of its development costs, and is entitled to the mill and mine. Corona bases its position on the fact that the improvements were made after it served notice on Lac that it was challenging its title to the mines and minerals lease
- **Issue**
    - What compensation should Lac receive for its costs of developing the property?
- **Analysis**
    - Section 37(1) of the Conveyancing and Law of Property Act indicates that when a person who makes improvements on land under the belief that it is his own, he or his assigns are entitled to a lien upon it to the extent of the amount by which its value is enhanced by the improvements, or are entitled or may be required to retain the land
        - The word "belief" means an honest and bona fide belief.
            - The reasonableness of the belief must be considered on an objective basis.
        - Lac's testimony is that it held an honest belief that it was the valid owner of the lands.
            - This is reasonable - why else would they spend over $200 million developing the mill and mine?
    - Corona testifies that it would have been able to develop the property more economically had it been the owner. Therefore, Corona contends that it should not have to compensate Lac for the full cost of Lac's improvements.
        - Judge finds that Corona would not have developed the additional mill for $85 million.
        - Therefore, Corona must pay Lac the cost of the improvements, minus the superfluous upgrades it would not have otherwise made, in order to restore Corona to the position it would have been in had it been allowed to develop the property itself
- **Holding**
    - Corona must pay Lac the cost of the improvements, minus the superfluous upgrades it would not have otherwise made, in order to restore Corona to the position it would have been in had it been allowed to develop the property itself; therefore, Lac must transfer the land to Corona, and Corona pays $153M instead of $203M for the improvements
- **SCC**
    - The SCC agrees that Corona is entitled to deduct the cost of any savings it would have realized had it developed the mine itself.
    - The operative principle of damages is to place Corona in the position it would have occupied had there been no breach of confidence by Lac.
    - Lac is responsible for the extra costs incurred as a result of the inability to take advantage of any natural economies of scale.
- **Ratio**
    - If the trespasser makes improvements to the lands, it will be entitled to compensation for those improvements unless the claimant can show that it would not have made those improvements, or could have done so more economically.
    - Principle of damages is to place the lessor or true owner in the position it would have occupied had there been no breach of confidence or trespass by lessor in the invalid lease
- **Notes**
    - Facts

        - "International Corona Resources Ltd., a junior mining company, carried out an extensive exploration program and made arrangements to attempt to acquire the Williams property. Representatives from a senior mining company, Lac Minerals, read of the test results in a public newsletter and arranged to visit the Corona property. Corona showed the Lac representatives confidential geological findings and disclosed the geological theory of the site and the importance of the Williams property. Detailed private information was left with Lac officials during further discussions about development and financing options. Corona was advised by Lac to aggressively pursue the Williams property. The matter of confidentiality was not raised."
        - "The Lac representatives, after their visit to Corona's site, instructed their personnel to gather information on the area in question and to stake favourable claims east of the Corona property. Lac acquired the Williams property but never informed Corona at any time of its intention of acquiring that property. Later negotiations between Lac and Corona for the Williams property to be turned over to Corona failed."
        - "Corona, after its relationship with Lac had ended, concluded various agreements with Teck Corporation. These agreements provided for a joint venture in developing a mine on the Corona property and purported to give Teck a 50 per cent interest in the fruits of Corona's lawsuit against Lac, with Teck agreeing to pay certain costs."
    - Issue
        - How to place Corona in the place it would have been in but for the breach of confidence
        - Title transfer is ordered; what money went back the other way? (p. 251)
            - *We do see UE principles play out…*
    - Court
        - Had C been in a position to develop both properties together based on improvements to the first property, how much would they have spent?
        - The $154M expenditure is a benefit that they can't deny they'll get with the property, but the extra money that Lac spent that C wouldn't have is what they can recoup. So Lac doesn't get the full $200M
        - **Not dissimilar to the outcome in *Champlin*, where the cost that is accounted for would have ultimately been incurred by the plaintiff, regardless**

Republic Resource Ltd v Ballem **(1982 ABQB) – Improvement May Not Have Been Made Anyway; Unsolicited Well; No Recovery of Costs to Lessee**

- **Facts**
    - Republic (lessee) farmed out an interest in its leasehold rights to the plaintiff Joffre Oils Ltd. ("Joffre") in consideration of Joffre undertaking to drill on the leased property.
    - The well was drilled near the end of the primary term, and was completed after the end of the primary term. After the primary term had ended, natural gas was discovered in commercial quantities and the well was prepared by the lessee for production and capped for lack of a market.
    - There had been an effort to deal with the ***Kininmonth*** problem, not in the habendum, but in the extension/continuous operation clause
        - The lease was dead and the lessor was left with a completed, capped well on their land, and knowledge that the well could be productive
    - Republic claims that they should be compensated for the improvements they have made to the land (drilling the well) via the doctrine of unjust enrichment.
        - They allege that the defendants (Ballem) received an incontrovertible benefit and it would be unjust to allow them to retain that advantage at the plaintiffs' expense.
        - They contend that they honestly believed in the validity of the lease, and sought legal counsel as soon as its validity was put into question.
        - Since the well is not yet producing, the plaintiffs have agreed that a lien on title would be sufficient compensation, and payments would not be made until the defendants started production from the well.
- **Issue**
    - If Republic and Joffre fail to have the lease restored, are they entitled to receive compensation for the well that it constructed?
- **Analysis**
    - **Principle from *Sohio*:**
        - Lessor of mineral rights may be required in equity to compensate a lessee for expenditures made in mistakenly drilling a well under an expired lease
    - **But: Benefit was unsolicited**
        - **A person who renders services to another, who has neither requested them nor freely accepted them in such circumstances that he knew or ought to have known that they were to be paid for, has generally no right to recover from the recipient remuneration for the work so done**
            - The defendant lessors (Ballem) had no knowledge that the well had been drilled until it was completed, and made no demands on the plaintiffs to drill the well.

- Compensation is also only required if the wronged party would have constructed the improvement themselves were they not prevented from doing so as a result of the tortfeasor's trespass.
- Also, since the well isn't actually producing, it would be unfair to force Ballem to pay for a well that they did not request (they have not accepted any benefits yet)

- **No incontrovertible benefit, merely a benefit that cannot be ascertained at the current time**
  - **Therefore, unjust enrichment was denied**
  - The existence of 13 other nearby capped wells of the plaintiffs has the effect of casting doubt on whether the costs of drilling the well, as claimed by the plaintiffs, equal the monetary value of such benefit to the defendant.
  - After all, there was no evidence as to when a market for the defendant's gas might develop or if the defendant would likely be on her own in eventually disposing of the gas from her holdings.
- Possible to argue an equitable lien (compensated when well brought back into production) or *Law of Property Act*, s. 69*:*
  - Improvements made on wrong land through error

- **Holding**
  - Application by the lessee for compensation for costs of the well were denied; the lessees were assuming certain calculated risks by commencing to drill and the lessor did not seek the drilling to be done, so they should not have to compensate for the improvements to their land
- **Ratio**
  - Compensation is only required if the wronged party would have constructed the improvement themselves were they not prevented from doing so as a result of the tortfeasor's trespass. Also, if the wronged party did not request or otherwise solicit the construction of the improvements by the tortfeasor, then they should not be required to pay for improvements that they did not solicit.
- **Notes**
  - Another situation of lease expiry
  - Lessee wants to recover the costs associated with completing the gas well – seeking restitution of benefits on the basis of unjust enrichment
  - *Sohio*: lessor of mineral rights may be required, by equity, to compensate a lessee for expenditures made in mistakenly drilling a well under an expired lease (limit of the precedent apparent at p. 253)
    - Neither the SKCA nor SCC discussed the principles on which they ordered restitutionary relief in the *Weyburn* case. So, hard to have a principle that doesn't go through how to get there
    - Republic thinks ***Sohio*** allows for UE
  - Possible to argue an **equitable lien** (compensated when well brought into production and marketed) or *LOPA* – If you had improvements that were made on wrong land or through error, you can try to file a lien to try to get their money back: "We need to be paid back for the benefits we made to the land"
    - *Law of Property Act* – Improvements made on wrong land through error
      - 69(1) When a person at any time has made lasting improvements on land under the belief that the land was the person's own, the person or the person's assigns
        - a) are entitled to a lien on the land to the extent of the amount by which the value of the land is enhanced by the improvements, or
        - b) are entitled to or may be required to retain the land if the Court is of the opinion or requires that this should be done having regard to what is just under all circumstances of the case
  - Is republic successful? No
  - Court
    - In order for UE to play out, we'd have to look at Ballem (D) and whether they requested Republic to do something
    - This didn't happen – a lease just preserves your option to do something
    - "They were neither deceived nor misled by the defendant or her authorized agent. The defendant did not seek the drilling to be carried out, and for all practical purposes she did not have the opportunity to express her legal position until after the well had been completed. In these circumstances, in my view, and having regard to the uncertainty of the value of the benefit in question to the defendant, this is not an appropriate case for extending the law of restitution"
      - *If dealing with on a fact pattern: Assert UE but be aware that it's likely to fail. Your better case in AB is to go for a statutory lien*

Takeaway Points

- **1. What tort to plead?**
  - Trespass (in property) v. Conversion (in chattel). It's questionable that the plaintiff has, at the material time, a sufficient possessory right to make out a case in conversion, but has been allowed in ***Freyberg*** and ***Stewart Estate***
- **2. What approach to damages?**

- Regardless of the tort that is plead, the proper measure of damages ought to be *compensatory* (this is the trend). The court's unnecessary reference to restitution and disgorgement (as a theory of restitution requiring the forfeiture of ill-gotten gains) complicates the discussion of compensatory damages. Additionally, ***Sohio*** allowed the lessee to profit beyond recouping operating costs

- **3. Role for unjust enrichment?**
  - As a cause of action (probably not – and in any event, to what end?) *versus* as a mechanism for accounting of benefit gained by lessor at lessee's expense
- **4. Lessor windfall?**
  - General problem with providing a remedy that turns on net proceeds of production is that this puts the plaintiff in a much better position than they otherwise could ever have hoped to be. (See Rowbotham in ***Stewart Estate***)
- **5. *Sohio* as precedent?**
  - It focuses on the notion of a "just and equitable" remedy. Can such broad language ever form the basis of a meaningful rule?

6. The Royalty Clause

Why the Royalty Approach Rather than Simple One-Time Payments?

- Factors
  - High production costs
    - People cannot always be paid in cash up front
  - Risk and speculation
- These factors support payment out of the monies recovered from completed future work

Royalties Qualify as a "Security"; Upshot is That They Are a Tradeable Financial Interest

- Royalties can be transferred, gifted – thus, they become a commodity itself

Oil and Gas Industry is Dynamic and Experiences a High Rate of Turnover; Thus, How a Royalty Ends Up Being Characterized is Important

- Is it a:
  - Contractual right: Enforceable between parties, or
    - % of proceeds of production, and that's it
    - Not registerable under the Land Titles Act and not binding on future purchasers
  - Interest in land: Enforceable against the world and binding upon future purchasers
    - Can be caveated on title
    - Carved out of the mineral estate
- Lessors (obviously) prefer the interest in land characterization
  - Registerable upon title (subject to fractional restraints)
  - E.g. Royalty maintained throughout transactions if lessees change

Difference Between Oil and Gas

- **Oil:** Commonly sold pre-refinement, and the basic separation costs (i.e., water exclusion) are generally borne by the producer (but see: ***Acanthus***); some basic transportation deductions are commonly borne proportionately by Lessor and Lessee
- **Gas:** Often sold post-processing and generally the Lessee will try to pass along the costs of transportation and processing to the Lessor
  - Lots of distillation processes so that they can be streamed into different routes
- **Most traditional leases say that the lessor is entitled to "an amount equal to the current market value on the said lands of 12.5% of all gas produced and marketed from the said lands"**
  - **How to determine the price on said lands?**
    - Are you actually selling it at the wellhead, or somewhere further down the production stream where processing has occurred?
- **Jumping Pound Formula:** Tailgate price (at plant once processed) and subtract from it costs of transportation, treating, and reasonable processing. This accounts for profit return on invested capital (FINAL EXAM SHORT ANSWER QUESTION)

- So even though it says, "on said lands", additional steps need to be taken into account
- **Problem:** steps not regulated; lessee can make unreasonable deductions that a lessor will not be able to properly assess

- **Problem addressed by the new industry standard CAPL lease**
  - **Allows for deductions but provides that "in any event the royalty shall not fall below _____% as a royalty that would have been payable had those expenses not been incurred"**
    - **This sets a minimum and inserts protection for the Lessor**
    - ***See CAPL99 lease royalty clause**
    - Example: If it is expected that the gas product will be clean and require little processing, it will not make sense for a large amount of costs to be deducted from the tailgate price – the lessor would therefore want to argue that the minimum should be close to the agreed royalty %

Crown Royalties

- **45+ page regulatory instrument that details exactly what deductions are permissible and the rate at which deductions can be made prior to the royalty being calculated and paid**
  - This stipulates a detailed jumping pound formula for both oil and gas
  - Limits the type of expenses that can be deducted from the tailgate price to determine the amount owing to the Crown

Lessor's Royalty

- Fractional share of production paid on production revenues (or in kind)
  - In kind: Would get a certain % of the product to do what you want
    - Older way of getting royalty
  - Now, it's more the revenues
- Reserved from the rights coming out of the initial grant to the Lessee
- A cost-free share of production carved out of the mineral estate (connected to the mineral estate itself)
- Upshot: It attaches to the mineral estate; thus, it is easy to argue that it is an interest in land. Why is this important?
  - You can trade it, register it on title, it can be an encumbrance that's going to follow the land

Gross Overriding Royalty

- Rights granted out of a lessee's interest by the lessee. Payable in addition to the lessor's royalty
- Common in farm-out arrangements and other lease assignments
- A cost-free share of production carved out of the working interest
- Harder to qualify as an interest in land. Why?
  - It's attached to the lease rather than being attached to the land/mineral estate (exists as a result of the lease instrument itself)
- "Gross, overriding" = not adjusted for costs incurred in productions (does not include costs)
- Ratable**:** Means that for every unit produced, the royalty must be paid
  - Lessee cannot save the % for portion of the minerals produced from the lease at a later time

Characterizing Royalties as Contractual Interests Or as Interests In Land

- **Traditional approach: Look to the instrument in question and assess its meaning to make a determination as to whether there was a conveyance of an interest in land**
  - Look at the language; more strict interpretation
- **Functional approach: Look to what the parties were setting down as their intentions *or* what they were setting out to achieve (and whether they were successful)**
  - Instead of the words, look at the intention of the parties and what did they set out to achieve (and did they achieve it

Gross vs Net Royalties

- **GROSS royalties:**
  - Calculate and pay the royalty on the gross amount of production/revenue from production. The royalty payor absorbs the costs of exploration/development and production
  - Payor absorbs costs
    - These aren't as good for the lessee, but better for the lessor
  - The costs that aren't being passed on: Upfront costs associated with drilling the well and moving forward with production
    - Note: Transportation costs usually are passed on and deducted
- **NET royalties:**

- Calculate and pay the royalty out of the net amount of production (i.e., what has been realized; the amount that accounts for the costs of exploration/production and development)
- Payor passes costs on
  - These aren't as good for the lessor, but better for the lessee

Acanthus Resources Ltd v Cunningham (1998 ABQB) – Treating Costs Deductible from Downstream Market Price to Determine Wellhead Price (Royalty to Lessor); Unique Situation

- **Facts**
  - Acanthus (the lessee) had a lease for the oil from Cunningham (the lessor) that provided a royalty payment of 17% of the market value of the oil at the wellhead.
  - The lessee claims that they are able to deduct treating costs, and that they have overpaid the royalty by the value of the treating costs.
  - The plaintiff lessee claimed a leasehold interest under the two leases and sought judgment for what it claimed were "excess" royalties which have been paid, and continue to be paid, to the defendant lessors
- **Issue**
  - What is the meaning of market value "at the wellhead" and can treating costs be deducted?
- **Analysis**
  - Deductibility of Treating Costs
    - The market point for oil is not "at the wellhead" but rather downstream at an inlet terminal of a nearby pipeline (this is standard practice in the oilfield).
      - **At the wellhead is interpreted as the market price for oil downstream with costs deducted that should be borne proportionately between the lessor and the lessee**
      - This includes transport expenses and treating costs (i.e. costs to separate water from the crude)
  - "A lessor's share is not subject to the costs of producing the substances and bringing them to the surface, but it is burdened with the share of the costs beyond this point"
    - Non-valid costs for deduction: costs for operating the well to bring the product to the service
    - A royalty is calculated on a net basis after the post-production costs are deducted.
  - **Outcome:**
    - The Court found that the costs sought to be deducted by the lessee were unreasonably high based on the lacking evidence, but allowed for a lesser cost to be deducted to lower the royalties owed
- **Holding**
  - The lessee can deduct treating costs from the downstream market price prior to determining market value at the wellhead (determining the royalty to pay to the lessor)
- **Ratio**
  - Market price at the wellhead includes a deduction for reasonable costs incurred after the oil has been produced, but before it can be put to market (transportation, treatment, etc.).
  - Price at the wellhead = price at which the gas was sold at the tailgate of the processing plant, minus the costs that were required to get it to the tailgate
- **Notes**
  - **Royalty scheme at p 255**
    - "The Lessor, does hereby reserve unto himself a gross royalty of seventeen (17) per cent of the leased substances produced and marketed from the said lands ... and the Lessee shall account to the Lessor for his said royalty share in accordance with the following provisions, namely:
    - The Lessee shall remit to the Lessor, on or before the 25th day of each month, (a) an amount equal to the current market value at the wellhead on the date of delivery of seventeen (17) per cent of the crude oil and crude naphtha produced, saved and marketed from the said lands during the preceding month"
  - **Lessee (plaintiff) claims interest in the lease to excess royalty payments. Deductions had been made for the transporting costs but not for treating costs (separating associated water); seeks return**
    - Contesting what has to be paid
    - Lessee had paid its royalties to the lessor deducing only the transportation cost, but not the initial treatment costs (separation of water); sought a return of the money it expended in error in overpaying the lessor
  - **Court:** Has to ask **whether or not allowed to make said deduction prior to royalty depends on the lease and interpretation of "market value at the well head"**
  - **Court: Lessors only burdened with the costs AFTER oil/gas brought to the surface and, in principle, that includes costs after the wellhead that are upstream of marketing (p. 257)**
    - Here, unique circumstance where there was some additional treatment required that allowed the substance to be marketed and sold
    - Court: we won't allow for deductions in bringing it to the surface, but there are costs incurred after the wellhead that we'll allow deductions for. Here, because of the extraordinary steps done, this was an **okay** circumstance for these deductions to be proportionately borne
  - **Problem: Court has to settle on an amount because of insufficient evidence ($1/m^3)**

- Even though the P had the ability to claim these deductions, they didn't have the proper evidence: All they had was a bare assertion
- So, they had to look at what was reasonable in the circumstances → $1 per cubic metre (much less than what the P was looking for)
    - "It has been observed that the court is not a lottery."

Canpar Holdings Ltd v Petrobank Energy & Resources Ltd (2011 ABCA) – Refusal of Lessee to Pay Full Royalties on Fuel Gas; Ordered to Pay Outstanding Royalties but Disgorgement and Lease Remains Valid

- **Facts**
    - Canpar (the lessor) leased certain land to Petro (the lessee, appellant) for drilling operations upon receipt of a royalty of 17.5% of the gross amount of NG (without deductions)
    - In the drilling practice the lessee often used a portion of the NG as fuel gas for drilling operations.
    - The lessee argued that the 17.5% royalty should be calculated on net saleable gas (i.e. at the time that it reaches the market) and no royalty was owing for the "fuel gas" that was used during operations.
    - The lessor claimed damages for the unpaid royalty on the fuel gas, claimed that the lease was thereby void because of the breach and claimed a disgorgement of profits earned by the lessee during the time that the lease was void.
    - The trial judge interpreted the lease to require the lessee to pay royalties on the natural gas used by it as fuel gas; the royalties were to be based on the volume of refined produced gas, not on the volume of sold gas.
        - He determined that the lease was validly terminated for failure to pay the full resulting royalty amounts, declined to grant relief from forfeiture and ordered the lessee to disgorge its profits and to pay damages arising from the continued production after the date of termination.
- **Issue**
    - 1) Does royalty clause require appellant to pay royalties on fuel gas? (Yes)
    - 2) Is appellant entitled to equitable relief from forfeiture? (Yes)
        - I.e. Even if lessor is right, lease should not be terminated because conduct not egregious
- **Analysis**
    - What is fuel gas?
        - Natural gas used during operations for extracting petroleum
    - **Why the lease did not terminate:**
        - This situation is different from other potentially invalid lease situations like when shut-in payment or delay rental fee is not paid:
            - Non-payment of royalty: Breach of an obligation
                - So, default clauses of the lease are applicable – lessor will have to give notice and curative period if the payment is not made
            - Non-payment of shut-in: This is an option
                - No need for notice and curative period for the lease to terminate when the payment is not made
    - <u>1) Does the royalty clause under the lease require the lessee to pay royalties on fuel gas?</u>
        - **Royalty Clause stated:**
            - Lessee shall pay or cause to be paid to the Lessor a royalty in cash of 17.5% of the greater of the actual price received (including payments received from any source whatsoever in respect thereof) or the *current market value at the time and place of sale of all Leased Substances produced from the lands, all without any deductions*
                - Phrase "at the time and place of sale" has an agreed upon purpose in the lease, to establish that royalties are not payable on the volume of raw gas produced but on the volume of refined gas. Fuel gas is refined gas.
            - Added clause:
                - The Lessee shall dispose of the Lessor's royalty share of the Leased Substances produced from the Lands **ratably** with its own share of the Leased Substances
                    - Without an obligation to dispose of the natural gas ratably, the lessee could consider that 17.5% of the units of production belonged entirely to the Lessors with the balance belonging entirely to itself.
                    - Ratably means: Royalty based on each unit of production
            - Exclusion from what to be paid:
                - Costs for operations to extract the resource
            - Industry custom of allowing for deductions and use of the fuel gas without paying royalties on that fuel gas cannot be considered as an aide to contract interpretation in the absence of ambiguity and "all without any deductions" leaves little room for ambiguity
                - A royalty clause is specific on the method of royalty calculation; the amount calculated must properly reflect the agreement regardless of industry practice etc.
            - **On the basis of the contractual provisions:**

        - Deductions would have been allowed for the fuel gas if it was only being used for certain permitted purposes, rather than day-to-day use
        - Fuel gas constituted refined product and under the lease wording, the royalty was owing on all refined gas
    - 2) Appellant lessee entitled to relief from forfeiture?
        - Respondent lessor argues that equity will not assist a trespasser, and that the appellant became a trespasser when it failed to remedy its breach upon receiving notice of default.
            - **Trial judge:** "Relief from forfeiture is not readily granted in this industry for late payment of delay rentals and it cannot be granted in such a case as this, where there has been a purposeful underpayment both before and after notice of default has been given."
        - **3 factors guiding the discretion of courts in considering applications for relief from forfeiture under Alberta's Judicature Act:**
            - 1. The conduct of the applicant;
                - The lessee continued to pay the bulk of the royalties and did not act in a high handed fashion
            - 2. The gravity of the breaches; and
                - Breach here was a shortfall in an otherwise significant payment rather than a complete failure to pay (so it was a less significant breach)
            - 3. The disparity between the value of the property forfeited and the damage caused by the breach.
                - The trial judge ordered payment of close to $2 million in damages, about 12 times the sum of the actual damages caused by the breach
                - The Lessee here received an amount out of proportion to the arrears through the termination of the lease
        - **What was the appropriate remedy?**
            - The lessor was entitled to the royalty, but is **not** entitled to the full disgorgement of the profits and the lease was not void due to the lack of payment
                - The continued payment of the lower royalty value made a finding of disgorgement incorrect (i.e. not operating maliciously from a high-handed position etc.)
                - There was a huge disparity between the value of the property that would have had to have been forfeited versus the actual damages suffered by the lessor
                - Shows the compensatory (modern) approach to deal with circumstances of a breach of lease

- **Holding**
    - Appeal allowed; royalties were payable on the fuel gas produced under the lease but the trial judge erred in failing to grant relief from forfeiture (damages only granted for outstanding royalty payments and the lease remains valid and subsisting)
    - Relief in forfeiture here means that the lessor receives what was owing to them under the 17.5% royalties for production after the termination of the lease, but they are not granted disgorgement of the lessee's profits
- **Ratio**
    - Royalties payable on the fuel gas depend on the words of the royalty clause
    - Relief from forfeiture may be granted based on 3-part test to allow lease to continue even where royalties were not properly paid.
- **Notes**
    - **Facts** (p. 258)
        - Have a lessee that was producing gas, and using some of it as a fuel onsite for further production (saving costs). Took the position that this was appropriate under the lease, and didn't have to pay royalties on it. Lessees kept paying royalties on this position
        - Lessor said that the royalty had to be paid on everything
    - **Issues**
        - Does the royalty clause require royalty payment on fuel gas? – what is "fuel gas"?
        - Is relief from forfeiture available?
    - ***Trial*: Royalty on fuel gas owed (CA: Upheld); relief from forfeiture not granted (CA: Erred)**
    - Make sure you know what fuel gas. If you want to exempt it, the best course of action is to have a **standalone** clause
        - Note: 3(d) in this case didn't explicitly contemplate "fuel gas", so this doesn't count as an exempting clause

5. THE NATURE OF ROYALTIES

1. STATUTORY PROVISIONS

Things to Keep in Mind

- **1. Net v. Gross**

- **2. Lessor's Royalty v. Gross Overriding Royalty**
- **3. Contractual Interest v. Interest in Land**
    - **The test for characterization [traditional v. functional]**
    - **Important difference [interest in land can bind future purchasers; attaches to % of mineral *in situ* or only to a % return on production]**
- **4. Qualify as a "security" (see ss. 1(x) & (xi) of *Securities Act*) (p. 266)**
    - 1. In this Act
        - (ggg) "security" includes
            - (x) any certificate of interest in an oil, natural gas or mining lease, claim or royalty voting trust certificate;
            - (xi) any oil or natural gas royalties or leases or fractional or other interest in them;

2. ROYALTIES IN GENERAL

Overriding Questions

- What is the approach we use to determine whether or not something like a royalty can be characterized as an interest in land?
- Also know broad trend of where jurisprudence is going

Bensette v Reece (1969 SKQB) – Royalties Retained by Original Landowner Can Be Interests In Land That Can Be Registered On Title; If Intended to Be % of the Substances in Situ; Wording of Conveyance

- **Facts**
    - The CPR became owner of the lands in 1904 and 1905 by a direct grant from the Crown. The grant included all mines and minerals, except gold and silver. CPR transferred title to Powell in 1909, reserving coal rights for the CPR. Title was transferred several more times, subject to the same coal reservation.
    - Successor in title Burke sold land to Brooks in 1939 reserving "all mines, minerals and mineral oils."
    - Burke entered into a separate agreement to be paid a royalty of 6% for all minerals developed on the lands.
        - The land titles office carelessly did not include the mineral reservation in the title document (only the coal reservation was reflected).
        - Several further transactions were made where only the coal reservation was reflected on title.
    - The question is whether subsequent purchasers (D) are bound by the royalty reservation if it was erroneously not reflected on title.
    - The plaintiffs (purported successor of Burke) are claiming a 6% royalty on all oil, gas, petroleum, mineral oils, mines and minerals in the defendant's title already produced from that land, an accounting of all said royalties on the production of the substances, and an order that the plaintiff's mineral interest was always properly registered on title.
- **Issues**
    - Is the plaintiff, as the purported successor in title to Burke's mineral reservation, entitled to that reservation notwithstanding the fact that several transfers of the land have been made without that reservation being reflected? Is a royalty interest and interest in land that can be registered on title?
- **Analysis**
    - **Did the plaintiffs obtain an "interest in land" under P. 26 of the conveyance agreement or merely a contractual right?**
        - The defendants contend that the plaintiff was not validly registering any "interest in land" (by withholding a 6% royalty in oil, gas, petroleum, etc.) - which is required to register a caveat via the Land Titles Act.
            - At the time that Burke's interest was registered, there was oil beneath the ground in a reservoir, but its existence did not become known until 1958 when a well was drilled.
        - The uncertainty as to what minerals were actually contained in the land constituted no bar to Burke as the owner thereof from disposing of interests in whatever minerals might be present and otherwise severing them from the general realty (following ***Berkheiser)***.
            - A right to a royalty in minerals may be granted by their owner before any lease or other contract has been entered into to explore for or develop them
            - An owner of land is free to split their estate by granting surface ownership and retaining interest in the mineral estate; owner of minerals can convey a fractional interest in them to another
    - **Royalties**
        - "Royalty" is a term generally applied to a fractional interest in the production of oil and gas which is created by the owner either by reservation when entering into an oil and gas lease or by direct grant to a third person.
        - Given the words of the agreement, the royalty reserves 6% of the substances under the land for Burke and his successors.
        - The royalty interest is therefore an interest in land that can be registered on title
- **Holding**

- A landowner can reserve a % of the mineral estate as a royalty; such a reservation is an interest in land that can be registered on title, so a royalty that is based on a % of the actual mineral estate is an actual interest in land
- Plaintiffs obtained interest in land which entitled them to register caveat against certificate of title to said land

- **Ratio**
  - Validly owned mineral estates can transfer fractional interests in said estate. Q: what is the nature of the interest created through language used? If intention is to grant interest in substances *themselves* in situ (as opposed to a percentage of *proceeds* after production), such royalties can be characterized as an interest in land, which can be caveated against the certificate of title, making it known and binding upon future purchasers

Bensette v Reece **(1973 SKCA) – 6% Royalty "In the Minerals" is An Interest in Land that Can Be Registered on Title; Language of Conveyance Important; Interest "In Minerals", Not Interest "On Minerals"**

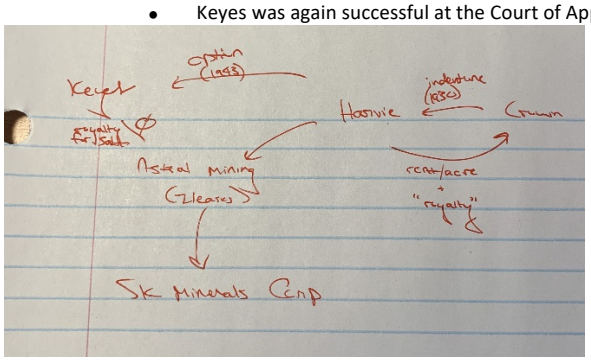
- **Facts**
  - Same as above
- **Decision**
  - The Court of Appeal agrees with the trial judge's finding that a 6% royalty for minerals is an "interest in land" capable of being registered on title.
  - The words "royalty in the minerals" connotes an interest of some kind "in" the minerals.
    - Other forms of language may not lead to that inference (i.e. interest on the minerals, payment on the minerals etc.).
    - In obiter, suggested that "royalty ON" would connote some kind of commission, which is not an interest in land and would be contractual in nature
  - Therefore, you must look at the specific construction of the grant to determine if it is an "interest in land" capable of registration on title
  - **Suggestion for drafting:**
    - Seek clarity in the drafting; be clear that what is being granted is a "royalty interest in the minerals on the lands" and not some mere commission on speculative production
- **Ratio**
  - Must look at the specific construction of the grant to determine if it is an "interest in land" capable of registration on title.
- **Notes**
  - Facts
    - Plaintiff seeks declaration of entitlement to 6% royalty in oil/gas/minerals of defendant's title + accounting
    - Considerable number of transfers post-Crown grant to the CPR; land ends up with a development company ("Burke") that purchased 36 quarter sections (surface + mineral, reserving coal)
    - Two shareholders in Burke look to remove themselves from the corporation and, as compensation upon exit, get "*6% royalty in all said mineral rights so acquired*" on the lands
    - The individuals down the road want to get accounting on that royalty interest (try to recoup the amount of money)
  - Issue:
    - Contractual right that terminated upon sale of the land or an interest in land that runs with the title and was payable upon development?
      - Q: The bargain that was struck – is it a contractual right that ended when the land was sold, or is it an interest in land that runs with the title?
        - I.e. What if Burke had turned around and sold the land?
  - Court
    - Validly owned mineral estates can transfer fractional interests in said estate
    - Such interests can subsequently be caveated against the certificate of title, which then makes it known and binding upon future purchasers (something that runs with the land)
      - Future purchasers take the land subject to these interests
    - If a caveat is challenged, you will have to defend it; failure to defend means it is stricken from title
    - Seek clarity in drafting; be clear that what is being granted is a "*royalty interest in the minerals on the lands*" and not some mere commission from speculative production
    - Turns on a technical reading of the language
      - This sets a trend
      - "Had the words "interest" or "property" been used instead of "royalty", it would be clear that an interest in the minerals themselves was to pass. Had the words "payment on" been used instead of "royalty in", intention to pass an interest in rem would not be inferable. The question is then as to what is meant by a "royalty" in "the minerals"."
        - Court focuses on a 2-letter word to figure this out essentially: **In** the minerals – sufficient to find that hook to bring it within the in situ mineral interest (attach the royalty to the minerals themselves)

Emerald Resources v Sterling Oil (1969 ABSC) – GOR On All Projects "Consummated"; Royalty Worded in Lease to Arise Only After Substances Severed from Realty and Brought to the Surface; Not Considered an Interest in Land; Determination Through Wording of Granting Device

- **Facts**
  - Emerald/Respondent (plaintiff) was employed by Sterling/appellant (defendant) to render geological services for one year from July 15, 1966 for remuneration plus 0.5% overriding royalty on properties in which appellant should acquire overriding royalty (by reason of property management contracts with Canadian Tricentrol and High Crest Oils in exchange for 2% GORR)
  - Emerald alleged that on January 14, 1967 this contract was altered to provide the royalty for interests acquired since April 1966 (even though the joint venture did not begin until July).
    - Also alleges that a new agreement was signed in December 1969 providing for increased base payments and the same overriding gross royalty on all projects CONSUMMATED by certain milestones, and provided that Emerald remains employed in good standing with Sterling.
  - Emerald alleges that the appellant breached its contract when it summarily terminated the contract without cause or notice.
    - The appellant is claiming that that the royalty agreement was never reduced to writing, and since it is an interest in land, this violates the Statute of Frauds and is therefore invalid.
  - Emerald is claiming damages from breach of contract and an order that the defendant convey to it an overriding royalty interest of 0.5% in all properties in which the appellant acquired an overriding interest during the period April 1966 to December 1969.
    - Emerald also sought an order for the appellant to convey to it a 1.25% working interest in certain specified projects
  - At trial, Emerald was successful in their application in gaining damages for breach of contract and a declaration of a 0.5% overriding royalty interest but their claim to a working interest was dismissed
- **Issues**
  - Should Emerald be entitled to an overriding royalty interest in the lands as described?
- **Analysis**
  - Court looks to the agreement itself and says this is a contractual right that will be enforced against Sterling as a result of their wrongful termination
    - That said, it is not proper to qualify this as an interest in land
  - **It is at least doubtful that an overriding royalty of the type claimed by Emerald is "an interest in land."**
    - The Court looked to the agreements formed by appellant in agreeing to confer royalties to Emerald and receive royalty interest in their projects
    - The purported wording of the royalty indicates that the royalty is ONLY to be paid AFTER the substances have been removed from the ground and severed from the realty.
      - The royalty is to be calculated and payable only upon the products mentioned after they have been taken from the ground and severed from the realty
    - It follows that the royalty interest, as constructed, is personalty since the right to it does not vest until the substances have been removed from the ground.
      - This provides a contractual right and not an interest in land
  - **If the contract was improperly terminated, what is the meaning of the word "consummated"? – overriding royalty was only to be granted in projects that were consummated**
    - The ordinary meaning of the word is "to bring to completion, to accomplish, fulfil, complete and finish."
    - An oil or gas project can hardly be said to be consummated until oil or gas is discovered therein.
      - Consequently, it appears that the overriding royalty was to be calculated on projects in which oil or gas were discovered during the period of employment.
  - **The improper termination of the contract cannot operate to deprive Emerald of rights already earned thereunder.**
    - Therefore, Emerald is entitled to a royalty on lands where oil and gas were discovered during the term of employment
- **Holding**
  - Emerald was entitled to one half of 1% gross overriding royalty interest in projects *consummated* (oil and gas was discovered) during Emerald's contract
- **Ratio**
  - The nature of a royalty interest is determined by the construction of the granting device. If the royalty only becomes operative after the substances have been severed from the realty and brought to the surface, then they are not considered "interests in land."
- **Notes**
  - Facts
    - Geologist (plaintiff) claiming on an overriding royalty contained within their employment contract (0.5%) – farmout on a farmout
    - Sterling (defendant) is a management and technical services company that manages oil operations and gets its own overriding royalty for doing so (2%)

- Court
  - Looks to the agreement itself and says this is a contractual right that we will enforce against Sterling as a result of their wrongful termination (failed to give notice or to terminate with cause)
  - That said, it is not proper to qualify this as an interest in land – "doubtful" that such a royalty can ever qualify
    - "It is in my opinion at least doubtful that an overriding royalty of the type claimed by the respondent is "an interest in land". The respondent claims to be entitled to 25% of the overriding royalty purported to be granted by High Crest and Tricentrol to Sterling under the terms of the agreements between those companies above referred to."

Saskatchewan Minerals v Keyes (1972 SCC) – Majority Says Royalty Not an Interest Because of Language and Ministerial Consent (Royalty Based on Production); Laskin Dissent Calls it an Interest in Land (Functional Approach)

- **Facts**
  - The appellant (Saskatchewan Minerals Corporation) is a Crown corporation and as such is an agent of the Crown. By an assignment from Astral Mining, it acquired "two alkali leases issued pursuant to the Alkali Mining Regulations."
  - The assignment was endorsed with a certificate of consent from the Minister.
  - Astral acquired these leases from Harvie, who had obtained mining rights from the Crown via an indenture in 1930.
  - The indenture required Harvie to pay to the Crown annual rent per acre and "such royalty as may from time to time be prescribed by or pursuant to the Mineral Resources Act."
  - Keyes claims that he is entitled to a royalty on all anhydrous salt produced from the lands on the basis of a contract he entered into with Astral.
    - Keyes pleaded that he had obtained an option from Harvie in the latter part of 1943 to purchase the rights under the two alkali leases. He eventually reached an agreement with Astral to develop the lands, and then exercised his option in 1948.
      - No evidence was adduced as to the existence of the option
      - The contract between Keyes and Astral states that part of the consideration for assigning the mineral rights was "a royalty of 25 cents per ton on all anhydrous salt produced from the said leasehold property."
    - The trial judge found that the option existed and it found that Keyes had an interest in land for the royalty that he held under the option.
      - Keyes was again successful at the Court of Appeal
  - 

- **Issues**
  - Was the royalty claimed by Keyes a valid "interest in the land"?
- **Analysis**
  - **In this case, the respondent cannot succeed unless the royalty which he claims by virtue of his agreement with Astral Mining & Resources dated June 3, 1948, is an interest in land.**
    - The royalty must be an interest in land for Keyes to be able to bind Saskatchewan Corp to paying the royalty, since there is no privity in contract between Keyes and Saskatchewan Corp
  - **Decision of the Court:**
    - **1) Agreement invalid for lack of Ministerial consent**
      - The agreement recites that the respondent has arranged to transfer to Astral an option to take over a lease entered into between the Minister of Natural Resources and Harvie.
      - **The option was invalid in the absence of written consent from the Minister of Mineral Resources (pursuant to s. 11 of the Alkali Mining Regulations).**
        - The regulation expressly prohibits transferring any part of the rights described in the lease to a third party without the Minister's written permission to do so.
    - **2) Construction of the lease agreement suggested that the royalty was only a contractual right**

- **The construction of the lease indicates that the lessor retains a set price (25 cents/tonne) <u>on the materials produced</u> (that is, substances once severed)**, therefore is NOT an interest in land, it is more akin to a contractual relationship.
- Use of the word "royalty" does not create an interest in the land; it will depend whether there was interest granted in the minerals in situ or whether it was granted on the materials produced (in which case the royalty is not an interest in land)
- The respondent has a contractual right enforceable against the conveyer, but not an interest in land enforceable against the appellant

- **Holding**
  - Appeal allowed; the option granted to Keyes was invalid for failing to receive the requisite consent of the Minister of Natural Resources and the royalty was not an interest in land because it was based on minerals that were produced, not on the minerals in situ
- **Dissent (Laskin J) - The royalty was an interest in the land**
  - **Laskin dissent appears to usher in a new approach that focuses much more heavily on the intention of the parties**
    - Do not focus on small differences in wording
    - Really, this isn't much different that surface rent for agricultural land where the rent is paid per acre or as a % of money earned off the crop
    - If a rent can be an interest in land, so should a mineral royalty
    - Rebuttable presumption that a royalty is an interest in land
    - In short, Laskin focuses on the function of a royalty
    - With respect to s. 11 (for Ministerial consent), it did not bar the creation of the interests
  - **Just as a profit a prendre may be incident to another interest or may exist in gross, so too may a royalty.**
    - As an interest in gross, it is freely assignable unless assignment is validly restricted.
      - This is consistent with the royalty being contractual and with being an interest in the land.
    - At common law, whether a royalty could be classified as an interest in land or not depended on whether it issued out of a "corporeal" interest (such as out of an estate in fee of minerals in place).
    - If the royalty agreement is analogous to rent, then the fact that the royalty is fixed and calculable as a money payment based on production or as a share of production, or of production and sale, cannot alone be enough to establish it as merely a contractual interest.
    - Therefore, it is possible that a royalty based on "production" can still be an interest in land.
      - Merely using the word "royalty" creates a rebuttable presumption that the parties intended to create an interest in land.
  - **The importance of the language of the lease/grant:**
    - This is not to say that every reservation or grant of a royalty creates an interest in land.
    - The words in which it is couched may show that only a contractual right to money or other benefit is prescribed.
    - The formulation here accords with language that has been held sufficient for the creation of an interest in land
  - **Ministerial consent was not required**
    - Laskin also said that the regulations would not prohibit the granting of an option for a lease and an overriding royalty in the minerals under the land; the Minister's consent would therefore not have been required to create the interest
- **Ratio**
  - The language of the grant matters for determining whether a royalty is an interest in land
  - Laskin in dissent says that a royalty can still be an interest in land though, even when the wording of the grant refers to a percentage of the minerals produced from the land
- **Notes**
  - Facts
    - Keyes had an option to take over a lease for salt reserves. Agreed to transfer this option under a contractual arrangement, in exchange for a royalty. Astral gets this land through a different route. However, Keyes, in transferring its option, argues it still has this royalty
  - Court agrees that for Keyes to succeed he needs to prove that his option agreement with Astral formed a royalty that was an interest in land
  - **Majority**
    - Not persuaded that it was more than a contractual agreement for a payment; likely endorses a traditional approach
    - Deals with it primarily by saying that any interest it created was rendered void by failing to secure Ministerial consent (s. 11 of the *Alkali Mining Regulations*); thus, only enforceable against Astral as a contractual right
    - Still, see language of intention of parties starting to creep in
  - **Laskin's dissent ushers in a functional approach that focuses heavily on the intention of the parties**
    - Do not focus on small differences in wording (i.e. *Bensette*)
    - Really, this isn't much different that surface rent for agricultural land where the rent is paid per acre or as a % of money earned off the crop that is produced
    - If a rent can be an interest in land, so should a mineral royalty
    - Start with a rebuttable presumption that a royalty is an interest in land

        - In short, Laskin focuses on the *function* of a royalty
        - With respect to s. 11, it did not bar the creation of these interests
    - **Takeaway**: When looking at a royalty, 2 approaches
        - Traditional – focuses on technical reading of language; find the right language in order to advance an argument that the royalty becomes an interest in the land that runs with the land
        - Laskin – look at the functional purpose; there's a rebuttable presumption that a royalty is an interest in the land

3. ROYALTY TRUST AGREEMENTS

Overview

- Common through the 1940s and 1950s in a burgeoning Alberta oil and gas market where farmers considered their options in dealing with uncertain returns on prospective oil and gas development
- RTA – farmers transfer their lessor royalty interests to the trust company in return for fractional trust certificates (see description on p. 271-272)
    - Way to hedge your bets – spread your interest out amongst many plots to get some part of a reward
- Trust companies register and caveat their interests and the farmers then traded or otherwise disposed of their certificates for value
    - Typically, 1 certificate per 1% of royalty – can trade these certificates

Guaranty Trust v Hetherington (1989 ABCA) – RTA Here Gave Contractual Right, Not Interest in Land; RTA Not Carved Out of Mineral Estate; Lease Expired and RTA Did Not Continue to Bind Successor Lessors; Traditional Approach

- **Facts**
    - In April 1948, Alden owned a fee simple estate in all mines and minerals under his quarter section of land. His sister owned mines and minerals under the adjoining quarter section.
    - In return for a 12.5% royalty payment, the Aldens entered into separate PNG leases with Rio Bravo whereby they leased all PNG rights for a primary term of 10 years to be extended by production. These royalties were protected by caveats.
    - In May 1952, the Aldens entered into separate gross royalty trust agreements with Prudential Trust whereby they assigned their gross royalty interests to Prudential. Guaranty is the successor of Prudential.
    - The PNG lease expired due to lack of production in 1958, and the Rio Bravo caveats were discharged.
    - Hetherington et al are the successors in title to the Aldens; Hetheringtons et al, in consideration for a gross royalty, leased the PNG to an oil company which successfully drilled for oil in 1979.
    - Guaranty then contended that all gross royalties made from production after 1979 should be assigned to it.
    - The trial judge interpreted the royalty trust agreement as assigning only a contractual right to receive royalty payments (to Guaranty) and did not create an interest in land necessary to support a caveat under the land titles system.
        - There was merely a contractual right to receive payment of a royalty calculated on the basis of a percentage of production that would arise from the lease entered into by the Aldens
- **Issue**
    - Is an RTA an interest in land that is registerable on title and binding on successors in title?
- **Analysis**
    - Court favored a traditional approach to interpreting royalties; focused on the language of the agreement itself;
        - Concludes that the interest created relates to production coming off of the working interest and does not attach to the minerals themselves
        - **The ABCA found that the RTA was clearly fashioned to apply only to the Rio Bravo lease** - the trust agreement was drafted to be coextensive with the recited Rio Bravo lease.
            - For that reason, it does not attach to the land and is not binding on successor leases.
    - The Court of Appeal did not address the larger issue at stake (whether a royalty trust agreement creates an interest in land), instead **deciding the case on the basis of clause 25 of the leases – the cancellation provision:**
        - This clause indicated that the lessor was only obligated to preserve a royalty in favour of Prudential, and its successor, Guaranty, *if the lease was cancelled*:
            - "Should the Rio Bravo lease be cancelled, then clause 25 becomes operable and substitutes royalties payable under the new lease for those payable under the cancelled Rio Bravo lease"
        - <u>The lease expired, it was not "cancelled",</u> so it was held that the royalty trust did not transfer to any new leases formed subsequently; the royalty agreement did not continue after the lease expired
    - <u>Problem</u>: There is no such thing as cancelling
- **Holding**
    - Appeal dismissed; the royalty trust agreements attached only to the royalties payable under the recited Rio Bravo leases, and since those leases expired, the new lessors need not pay royalties to Guaranty
- **Ratio**

- The construction of the royalty trust agreement will determine whether it was intended to attach to the land or was intended to create a contractual relationship that applies only to a specific PNG lease.

- **Notes**
  - Facts**:**
    - Lease (w/ Rio Bravo) in 1948 → Lessors create a RTAs with Prudential Trust Company (which becomes Guaranty Trust) in 1952 → Rio Bravo leases "expired by effluxion of time" in 1958 (primary term lapsed) → land sold in 1959 → new leases in 1979
    - Use of RTAs: pp. 272-273
  - Issue**:**
    - Did the lessee, who was producing in 1979, have to pay royalties to Guaranty Trust under the 1952 agreement?
  - Broader question: Does an RTA create an interest in land or simply a contractual right (and thus terminates upon a transfer of land)? This question goes unanswered by the Court of Appeal
  - See trial judge's reasoning on p. 273
    - "The language employed by the parties does not indicate an intention to assign an undivided fractional interest in the fee simple mineral title nor does it indicate an intention to assign any lesser interest in the mines and minerals in place. Rather, the words used disclose an intention to assign to Prudential Trust the benefit of the lessee's covenant to pay the Aldens an amount calculated as a percentage of the oil and gas produced from the lands and subsequently sold."
  - Focus on Appeal: Did the RTA only cover the royalties under the original Bravo (elapsed) leases or did it extend to cover current (productive) leases?
  - Interplay between Clauses 2 & 25 (p. 273) - PTC-1 form
    - Clause 2: Seems to be significant transfer (lessor's whole interest is transferred forever to the trust company)
    - Clause 25: in event no lease currently exists or is cancelled, lessor will reserve back to trust company the 12.5%
      - Was the original Bravo lease cancelled? No – it just expired
      - Primary term lapsed in accordance with its own life span
      - No situation whereby conditions of 25 were met leading to obligation on lessor to ensure subsequent agreements were burdened by the same royalty arrangement
  - Court favours a traditional approach; focuses on the language of the agreement itself; concludes that the interest created relates to **production** coming from the **working interest** and does not attach to the minerals themselves
  - Upshot: future purchasers not bound/not tied/restricted by the original agreement
  - Unsatisfactory resolution that led to additional test case litigation

Scurry Rainbow v Galloway Estate **(1993 ABQB) – RTAs Found to Be Interests in Land; Functional Approach (From Laskin Dissent in *Keyes*)**

- **Facts**
  - This case involves the question of whether royalty interests created by freeholders under a variety of royalty trust agreements constituted an interest in land.
  - The language used in the royalty trusts varied considerably, and the wording was vague and weak.
  - The wording of one royalty trust agreement was identical to the wording of the agreement in ***Guaranty Trust*** (referencing the specific lease on which the royalty being issued)
  - For another, the wording varied considerably and did not reference the specific PNG lease that was in force at the time.
- **Issues**
  - How are RTAs to be interpreted? When will they create interests in land, if at all?
- **Analysis**
  - **Return to Laskin's functional approach (pg. 276):**
    - 1) Lessor's royalty easily qualifies as an interest in land
    - 2) Looks to the intention behind the creation of RTAs, the role that the payments play in maintaining the trusts, and concludes that the lessees in question did have to pay
  - **1) Is the lessor's royalty under the oil and gas lease an interest in land?**
    - The lessors' royalties are unquestionably "interests in land" as they apply to the PNG leases themselves.
  - **2) What about the royalty are assigned to a trust company?**
    - **The Court looked to the language used in the trust agreement to interpret intent of the parties in the royalty trust agreement:**
      - The ***Hetherington*** clause used specific words that are typically used to indicate a conveyance of land interest (i.e. grant, bargain, sell, assign, transfer and set over all the estate, right, title, interest, claim and demand whatsoever, both in law and equity).
      - This is a broad-ranging clause that suggests that a higher interest was being transferred, and not just a temporary contractual arrangement.

- Also, the royalty trust agreement refers to taking 12.5% of the substances produced - nothing indicates that it was intended to only be taken as cash.
    - Again, this is typically used in PNG leases to confirm an interest in land.
- The trust agreement was also to be fully transferrable and the agreement could be cancelled, but only by consent
- **Entire scheme contemplated by the trust document confirms that the parties intended there to be an assignment of an interest in land**

- The Court here comes to a different conclusion than the court in ***Hetherington***.

- **Holding**
    - Court found that all the royalty interests in the case constituted interests in land
- **Ratio**
    - If the language used in a royalty trust agreement is similar to language used in PNG leases with respect to royalty rights, then it is possible that they create interests in land that will bind successors in title.

Scurry Rainbow Oil v Galloway Estate (1994 ABCA) – Lessor's Royalty Interest is an Interest in Land and Can be Protected Via Caveat; RTAs Here Found to Be Interests in Land Carved out of Mineral Estate

- **Facts**
    - See above
- **Issue**
    - Did the TJ get it right?
- **Decision**
    - The **ABCA supports the findings of the ABQB that a royalty interest is an interest in land**
        - In each RTA, the lessor retained not only a reversionary right to the lessee's profit a prendre on the leased substances, but also a fee simple interest in those substances in situ, as constituted by the royalty reserved to the lessor in the lease.
            - That interest is, of course, subject to the grant under the lease of a profit a prendre to the lessee
- **Ratio**
    - The ABQB got it right - the lessor's royalty interest is an interest in land that can be protected via caveat and will bind successors in title.
- **Notes**
    - Here we get a different conclusion – takes more of a functional approach like Laskin in ***Keyes***
    - Concludes that
        - 1) A lessor's royalty is an interest in land
        - 2) The Lessor can transfer to the trust company the royalty, which is carved out of the mineral estate
            - While the enjoyment of this interest may be postponed, there is no postponement of the vesting of the interest itself (that is, it does not create a perpetuities problem)
        - 3) The initial PNG lease is correctly categorized as a grant of a profit a prendre to the lessee, and the lessee's profit a prendre is something less than a fee simple transfer
            - It is a grant to permit the lessee to mine, operate and produce the leased substances.
        - 4) Following the grant of the lease, the grantor-lessor is left with two things that are both clearly interests in land:
            - A fee simple interest in the subject minerals in situ, but subject to the grant of the profit a prendre
            - The reversionary interest in the subject minerals with respect to the lessee's profit a prendre.
    - Upshot: RTA created an interest in land and that the landowner was obliged to reserve a royalty covered by an RTA in subsequent leases
        - The land becomes burdened by that arrangement; it continues with the land; you need to account for a previously-created RTA
    - Note that this construction accords with ***Berkheiser*** and American decisions
        - The concept that royalty reserved to a lessor in an oil and gas lease is considered to be real property is commonly accepted in American courts

4. The Last Word

Bank of Montreal v Dynex Petroleum Ltd (2002 SCC) – GOR Interest Can Be an Interest in Land (Depending on Language and Intention - Functional Approach); Dynex Goes Bankrupt; BMO Seeks to Sell Oil and Gas Properties That Have Overriding Royalties Held by Other Creditors

- **Facts**
    - The Bank of Montreal is a secured creditor of Dynex. The trustee in bankruptcy wanted to sell all the oil and gas properties of Dynex.

- One issue was whether any such sale would be subject to overriding royalties arising out of the working interest held by Dynex.
- Other creditors claimed that their overriding royalty interests (granted to them by Dynex) should take precedence over Bank of Montreal's desire to sell the oil and gas properties.
- BMO made an application for a determination that, as a matter of law, an overriding royalty is incapable of being an interest in land
- The Alberta Court of Appeal held that an overriding royalty is capable of being an interest in land

- **Issues**
  - Can an overriding royalty issued from a working interest (an incorporeal hereditament) be an interest in land?
- **Analysis**
  - Court recognizes that Laskin's approach overrules existing common law such that an incorporeal hereditament CAN create an interest in land (subject to clear intentions)
  - **At common law, an interest in land could issue from a corporeal hereditament but not from an incorporeal hereditament**.
    - "Corporeal hereditament" is defined by as:
      - 1. A material object in contrast to a right. It may include land, buildings, minerals, trees or fixtures....
      - 2. Land.
    - "Incorporeal hereditament" is defined as:
      - 1. [A right] in land, which [includes] such things as rent charges, annuities, easements, profits à prendre, and so on
      - A tangible right
    - Therefore, a royalty interest that stemmed from an incorporeal hereditament like a profit a prendre was traditionally not viewed as an interest in land
  - **It was noted that changes to the rules of common law are necessary and justified:**
    - (1) To keep the common law in step with the evolution of society,
    - (2) To clarify a legal principle, or
    - (3) To resolve an inconsistency.
  - **The owner of minerals in situ will lease to a potential producer the right to extract such minerals.**
    - This right is known as a **"working interest."**
      - A **royalty is therefore an unencumbered share or fractional interest in the gross production of such working interest.**
      - An overriding royalty is a royalty granted normally by the owner of a working interest to a third party in exchange for consideration including money and services.
  - In ***Keyes***, Laskin J argues that the old common law distinction between corporeal and incorporeal hereditaments is not helpful, and is an anachronism that does not fit modern oil industry practice in this area.
    - Laskin J believed that there was **nothing distinct about the overriding royalty interest as compared to the lessor's royalty interest** - **therefore both should be considered interests in land.**
    - Given the strong industry practice, it is proper and reasonable that the law should acknowledge that an overriding royalty interest can, subject to the intention of the parties, be an interest in land.
      - Jefferies thinks this indicates something similar to what Laskin said in ***Keyes*** about there being a rebuttable presumption that royalties are interests in land
  - **A "royalty interest" or an "overriding royalty interest" can be an interest in land if:**
    - 1) **The language used** in describing the interest is sufficiently precise to show that the parties intended the royalty to be a grant of an interest in land, rather than a contractual right to a portion of the oil and gas substances recovered from the land; and
    - 2) The interest, out of which the royalty is carved, is itself an interest in land.
- **Holding**
  - Appeal dismissed; overriding royalties can be interests in land
- **Ratio**
  - An overriding royalty interest can, subject to the intention of the parties, be an interest in the land
- **Notes**
  - *Issue*: Can a gross overriding royalty constitute an interest in land (i.e., can an overriding royalty issued from a working interest [an incorporeal hereditament] be an interest in land)?
  - Here, arises in the context of bankruptcy proceedings and liquidation of assets being subject to a GOR
  - Bank argues that, as per the common law, you can NEVER create an interest in land out of an incorporeal hereditament
  - Court recognizes that Laskin's approach in ***Keyes*** overrules existing common law such that an incorporeal hereditament (like a profit a prendre) **can** create an interest in land (subject to clear intentions to the alternative)
    - Majority takes ***Keyes*** dissent and makes it the SCC law
  - Another example of the courts looking to the unique properties of the oil and gas industry and legal instruments

Bank of Montreal v Dynex Petroleum **(2003 ABQB) – Royalty or GOR May Be Interest in Land, But Language Must Show Intention to Create Such Interest and Royalty Must Be Carved Out of an Interest in Land (E.g. Minerals In Situ); Functional Approach Narrowed/Not Really Applied**

- **Facts**
  - The SCC remitted the above matter back to trial to determine whether, on the facts of this case, each overriding royalty constituted an interest in land.
- **Issue**
  - Are the interests all properly classified as interest in land?
- **Analysis**
  - Trial seems to take us right back to the traditional approach to determine that no interest in land has been created (follows more of a traditional approach, with attention to the language used in the transfer of interest)
  - **It appears that, under Canadian law, an "overriding royalty interest" can be an interest in land if:**
    - 1. The language used in describing the interest is sufficiently precise to show that the parties intended the royalty to be a grant of interest in land, rather than a contractual right to a portion of the oil and gas substances recovered from the land
    - 2. The interest out of which the royalty is carved is itself an interest in land
  - **On the specific construction of these leases, the parties did not intend for the overriding royalties to constitute interests in the land.**
    - In this case, there is no language which allows the holder of the overriding royalty interest to take substances in kind, and there is no specific language that indicates a transfer of an interest in land.
      - Therefore, they are properly classified as contractual rights that do not attach to title or bind successors in title.
      - **The language used here was:**
        - Royalties granted on the basis of net petroleum substances produced, saved and sold from the lands
    - If the royalties pertain to "minerals produced, saved and sold" - then they do not create interests in land because the apply to the substances only after they have been severed from the realty.
  - Owners of mineral rights should be able to create royalties as property rights in the minerals if they make clear their intent to do so.
- **Holding**
  - Gross overriding royalties in this case were not interests in land, as that interest was not intended by the parties who made the royalty agreements (as indicated by the language in the agreements); the royalties were contractual rights so the holders of those royalties are unsecured creditors
- **Ratio**
  - You must look at the language of each overriding royalty contract to determine if the parties actually intended to transfer an interest in land, or merely to create a contractual relationship binding only them and not future successors in title.
- **Notes**
  - Remitted to trial for a determination on whether an interest in land was created
  - Trial seems to take us right back to the traditional approach to determine that no interest in land has been created
  - Cognizant of the Court of Appeal's warning of "searching for some magic words", but then does just that…
  - Where does this leave us? Some uncertainty, but a strong argument to be made that the modern functional test is more appropriate and that a GOR **can** create an interest in land
  - Upshot: Attach royalties to the M&M themselves, or at least the working interest in same; be clear in intention
    - I.e. "this is an interest in the land"

Third Eye Capital v Dianor Resources Inc **(2018 ONCA) – Confirming the Approach in *Dynex*; Persuasive**

- **Facts:**
  - Third Eye was a secured creditor of Dianor who went bankrupt; Dianor owned the rights to a variety of mining areas – which were subject to a GOR held by a numbered Ontario company; Dianor's appointed receiver wanted to sell those mining interests; the GORR was registered as a caveat on title
- **Issue:**
  - Do these GORs run with the land?
- **Analysis**
  - Clause 4.1 explicitly states it was the intention of the parties that the "GOR constitute a covenant and an interest in land running with the property … and all successions thereof or leases which may replace them"
  - Furthermore, they were registered on title as a caveat
- **Holding:**
  - Appeal allowed – these GORs are interests in land
- **Ratio**
  - A GOR is an interest in the land
- **Notes**

- Facts:
  - Bankruptcy of Dianor, with an appointed receiver. Sale of mineral interests in a diamond mine to Third Eye, which is seeking a vesting order. Opposed by a numbered company claiming that the property is subject to its gross overriding royalty interests, which it has refused to release and argues is an interest in land
- Court
  - Acknowledges the SCC's decision in *Dynex* and summarizes the important aspects of what might qualify as an interest in land (p. 280)
  - Concludes that a GOR is an interest in land that can run with the land
- Note: This is just persuasive, since it's ON

Main Takeaways

- 2 different approaches to qualifying an interest in land in connection with the lease
  - Traditional approach – strictly interpret words of the contract
  - Functional approach
    - As cases move along, we see a trend of this approach being endorsed. Despite the difficulties of some inferior courts applying it, ***Third Eye Capital*** seems to confirm what the SCC said in ***Dynex*** (Laskin's dissent in ***Keyes***)
    - Need clear intention (clear language) to rebut presumption of a royalty being an interest in the land

6. CROWN DISPOSITIONS

1. Alberta Petroleum and Natural Gas Agreements

Introduction

Overview

- Most o/g is owned by the Crown – they have their own system under statutory instruments
- Need to know how they're different from freehold scenarios

The Common Approach

- **Oil and gas producing nations start with favourable royalty/leasing/licensing schemes to attract foreign investment. Then, they gradually tighten the regulatory noose to retain more of the profit from the extracted resources**
  - *Pre-1962*: 21-year leases were common – entice exploration
    - Lengthy; trying to attract business potential to AB
  - *1962-1976*: 10-year leases – realize gains
    - Mechanisms now in place, but government was able to realize more benefits
  - *1976-present*: 5-year leases – enhance gains
    - Lots of interest in the conventional and unconventionals

Alberta's Two-Tier System

The Two Tiers

- In 1976, the Crown set up a two-tier system
  - **1. Licenses**
    - To explore; to prove that an area holds resources
  - **2. Leases**
    - For development purposes (looks like the leases we've seen in the freehold scenario)
    - In areas you already know have resources
- Clauses common to both
  - i. Granting clause
  - ii. Royalty clause
    - The initial bonus for the crown is the amount that you pay for the lands through the tendering process
    - **Surface Fee:** A yearly surface fee is also reserved for the government (a rental rate)
    - **Royalty Rate:** The amount stipulated from time to time under the MMA, this is basically a variable rate according to current government policy

- iii. Land rights
  - **No warranty of title** (***Champlin*** problem may arise) as the Crown says it grants only insofar as it has the right to do so (crown land registry is not under the Torrens system)
  - Crown lease: **Compliance with laws clause** – abide by all rules stipulated, both now and any new ones in the future
- iv. Continuation

Regulations that Govern Leases/Licenses

- **Licenses and leases are governed by** (based on resource type)**:**
  - ***Petroleum and Natural Gas Tenure Regulation (PNGTR)***
    - Applicable to conventional oil and gas projects
  - ***Oil Sands Tenure Regulation***
    - Applicable to oil sands projects (unconventional)

MMA, S. 16 – Alberta Energy Authorization to Dispose of Leases/Licenses in Different Ways

- **By virtue of s. 16 of the *Mines and Minerals Act*, Alberta Energy (Ministry) is authorized to dispose of petroleum and natural gas leases and licenses in different ways** (these are different than what you'd see under a freehold scenario where a land agent would come and negotiate a lease with you):
  - **1. On application, if the Minister considers the issuance of the agreement warranted in the circumstances;**
    - Minority of scenarios
  - **2. By way of sale by public tender conducted in a manner determined by the Minister; or**
    - Most common
    - There will be a rolling release of o/g leases in the province: A couple major sales per year
  - **3. Pursuant to any other procedure determined by the Minister.**
    - Minority of scenarios
- **Query: How does this interact with the role of the AER?** – Are there any issues having the 2 actors occupy the same field?
  - No, the Alberta Energy system disposes of leases/licenses (lease agreement between the lessee and AE), and the AER sets the regulatory structures within which development can happen → they complement each other
- **Alberta Energy:**
  - "Alberta's Crown petroleum and natural gas rights are issued in the form of licenses or leases through a competitive bid auction system. Public offerings (or sales) of petroleum and natural gas rights are held every two weeks. Notice of the parcels being offered are published on the department's website approximately eight weeks prior to the sale."
    - 2 major moments during selling period (offerings and notice)
  - The Crown attaches expectations to licenses and leases:
    - Annual rent of $3.50 per hectare must be paid for the area covered by the agreement
    - Tenure holders must meet all regulatory requirements; lands in a license are earned by the drilling of a well
      - What you need to accomplish during the license period
    - A lease is proven productive at the end of its five-year term by drilling, producing, mapping, being part of a unit agreement or by paying offset compensation
    - If a lease is proven to be productive, it will continue indefinitely beyond the end of the term

PNGTR Definitions and Region Designation

- **S. 1(j) – "licence" defined – for *exploratory* purposes**
- **S. 1(i) – "lease" defined – for *development* purposes**
- **Also, province broken into "regions" – "Plains"; "Northern"; and "Foothills"**
  - **Region designation is important for initial term and maximum area designations; defined in Schedule 1 to the *PNGTR***

License Process from Part 1 of the PNGTR

- **1. Initial terms set in s. 6(1); maximum areas set in s. 7 – This responds to differing geology, topography, and accessibility concerns**
  - **Initial terms and maximum areas:**
    - Plains (15 sections for 2 years)
    - Northern region (32 sections for 4 years)

        - Foothills (36 sections for 5 years)
    - Plains region – an area easy to comparatively explore
    - Northern or foothills – more difficult to access and are less explored; you get more time and more area to explore
- **2. General obligation during the initial term is to "evaluate" the licensed rights** (get on land, explore, and drill)**; "validation" must be done during the initial term**
- **3. Validating wells – individually or grouped – are to be approved by the Minister**
    - Can validate individually or by group
    - **Validating well:** a well drilled to a certain depth in the initial term
    - **Grouping wells:** By drilling one well you can validate your licenses on adjacent lands
        - Can validate one and claim from nature of reserve that another licence in the area is similarly validated
- **4. If validated, apply for 5 year "intermediate" term under s. 11** (exclusive right to secure production from that land); prescription of approved intermediate term depends on the depth of the validating well
    - I.e. at a minimum depth of 2100m, a certain number of sections can be maintained for the intermediate term:
        - Plains: (keep 8 out of 15 sections)
        - Northern (11 out of 32 sections)
        - Foothills (14 out of the 36 sections).
- **5. If selected land proven to be "productive" or "producing" (as defined) then the license will continue indefinitely, like a lease**
    - Licence remains valid as long as production is continued

Lease Process from Part 2 of the PNGTR

- **1. As per s. 81(1) of the *Mines and Minerals Act*, the Primary Term for a lease with the Crown is for 5 years**
- **2. The lease expires at the end of the primary term unless development has proven to be productive or producing (or as otherwise defined)**
- ***3. Formally, continuation of the lease past the primary term requires Ministerial approval (ss. 14 & 15 of the *PNGTR*)***
    - Extra step you wouldn't see in a freehold scenario
- **4. Notably, continuation can occur as a result of: i) production/productivity of related areas; or ii) based on the drilling of a "qualifying well" (a well that qualifies in the Minister's opinion that is sufficient to keep the instrument moving forward)**

Takeaways

- **What to know (good exam question)**
    - There is a 2 tier system – license and lease
    - Public auction process for distributing these instruments
    - License and lease have characteristics that differ
        - License – goal of exploration that is geographically influenced; validation into intermediate term, and eventually maybe productivity
        - Lease – Looks more like freehold scenario, with added step of ministerial approval at the end of primary term for continuation

2. Some Aspects of Leases/Licenses

(a) Continuation

Industrial Coal & Minerals Ltd v Alberta (1977 ABSC TD) – Abandoned Well Property of Crown; Lease Expired Because Crown Did Not Respond Promptly; Lease Declared Valid to Allow Lessee to Comply with Continuation Terms

- **Facts**
    - Applicant is a transferee of a PNG lease from the Crown that was for a term of 10 years (began in October, 1965) and was transferred to the applicant by Mesa Petroleum in August 1973.
    - There was an abandoned oil well on the lands from the previous lessee. The lease does not refer to the abandoned well.
        - The well had been abandoned by a previous lessee on March 13, 1955, 10 years prior to Mesa entering into the current lease in dispute (in 1965) and on the date of abandonment, it became the property of the Crown in the right of Alberta pursuant to the provisions of Section 51(1) of the Mines and Minerals Act.
    - At the end of the 10 year primary term, the lessee wrote to Director asking for the lease to be continued: Tries to take advantage of s 126(1) of the Mines and Minerals Act, which allows for the term to be extended if there is a producing well on the lands (also seeks reducing the rental payment on the basis that there is a well on the lands). Minister denied continuation upon application
    - No improvements were made to the well during the primary term; the Crown contends that this is required for that well to properly extend the lease.

- Also, the Crown contends that the abandoned well is not within the contemplation of the original lease to begin with.
- Applicant advances 2 main contentions
  - (1) Rights to abandoned well passed to him under the Crown PNG Lease; and
  - (2) Abandoned well is capable of production of natural gas in paying quantity (s. 109 MMA); lease should have been continued after primary 10-year term per s.126 MMA

- **Issue**
  - Were the rights to the abandoned well transferred to the lessee? Can a Crown lease be extended by the presence of an abandoned, non-producing well on the lands?
- **Analysis**
  - **Court reasons:**
    - 1) That the lease in question did not pass rights to the abandoned well
    - 2) However, the Crown failed to respond to the Applicant's contention that it qualified to lease continuation because of the abandoned well.
      - Thus, the Crown's correspondence did not qualify as notice of lease termination saved only by the drilling of a new well; that the Crown failed to afford the Applicant reasonable notice upon which to respond
  - **Applicant's first argument that the abandoned well passed to him under the Crown Lease**
    - Section 51 of the Mines and Minerals Act indicates that abandoned wells vest in the Crown.
    - A lessee can only claim rights only in what his lessor has granted to him, subject to the further qualification that the lessor cannot grant any rights he does not hold.
    - **Question is whether or not these rights were granted to the applicant:**
      - The Crown argues that, following ***Berkheiser***, oil and gas leases are profits a prendre, so the abandoned well could not have been transferred in the lease
        - **WRONG**: It is wrong to assert that all PNG leases are profits a prendre - that depends on the specific construction of the lease.
        - A lessor can sever any part of the realty that he owns, provided the part severed is not greater than the interest that the lessor owns.
      - Here, the lease grants unto the lessee the Crown's right to explore for, work, win and recover petroleum and natural gas (profit a prendre)
        - Nowhere in the lease does the Crown grant rights to abandoned wells.
        - This cannot be inferred, it must be explicitly included in the grant.
        - Therefore, the abandoned well was not granted
  - **The applicant asserted that the abandoned well was capable of production of natural gas in paying quantity, and that therefore his lease should be continued pursuant to Section 126.**
    - Section 109 indicates that a lease can be continued if there is a well that is, in the opinion of the Minister, "Capable of production of oil or gas in paying quantities."
      - The Minister must only address his mind to whether a well exists on the lands that is capable of production.
      - The lessee made requests to the Crown for clarification on this issue.
        - The Crown could have asked the lessee to conduct tests or upgrades on the well to bring it into productive use.
        - The Crown did not do so.
        - The Crown's delayed responses allowed the primary term of the lease to expire
      - It is manifestly unfair to allow the lease to expire after the lessee made bona fide efforts to comply with the legislation, and the government did not clarify whether those efforts were sufficient in advance.
        - <u>The Department failed in its duty to act fairly to the lessee by not responding promptly and with clarity</u>
  - **Remedy:** A declaratory judgment granted that the lease is continued to give the lessee reasonable opportunity to comply with the extension requirements under the lease
- **Holding**
  - Declaratory judgment made to hold the lease in full and force and effect to allow the lessee to comply with the extension requirements for the lease
- **Ratio**
  - If a lessee makes bona fide enquiries to the Crown on whether certain actions are sufficient to satisfy an extension clause for a Crown lease, then the Crown must respond in good faith and promptly to give the lessee the opportunity to comply.
- **Notes**
  - Facts
    - Applicant is the transferee of a Crown lease
    - Land subject to the transferred lease had an abandoned drill hole on it; present at time of lease execution
    - Applicant sought lease continuation under s. 126 of the *Mines and Minerals Act* – "producing well" and also reduction in rent payments (based on arguing that this should have been qualified as land with a producing well on it)
    - Crown contests applicability given that the gas well was abandoned; also asserted that the rights to the well were not passed from the Crown by the current lease
  - Applicant contends:

        - 1) That the rights to the abandoned well passed under the new lease
        - 2) That the abandoned well qualifies as being capable of production of natural gas in paying quantities (s. 109) and should have been continued by s. 126
    - Court reasons:
        - 1) That the lease in question did not pass rights to the abandoned well – why? (p. 286)
            - "Nowhere in that clause, nor in fact anywhere in the lease, does the Crown grant to the applicant the right to the abandoned well on the lands covered by the lease. For this reason the first contention raised by the applicant must in my view fail."
        - 2) That the Crown failed to respond to the Applicant's contention that it qualified for lease continuation because of the abandoned well. Thus, the Crown's correspondence did not qualify as notice of lease termination saved only by the drilling of a new well; that the Crown failed to afford the Applicant reasonable notice upon which to respond

R v Industrial Coal & Minerals Ltd **(1979 ABSC CA) – Trial Decision Overturned; Minister's Decision on Lack of Producing Well to Extend Lease Was Reasonable and Final; Insufficient Evidence to Show Crown Failed in its Response Duties**

- **Facts**
    - Industrial Coal had a 10 year PNG lease from the Crown dated October 1965. The lease, when granted, already had an abandoned well on it. All the casing had been pulled, and the shaft was cemented in. The appellant contends that this abandoned well is sufficient to continue the lease. The trial court said that the lease would be continued because the lessee made bona fide inquiries that were not satisfied by prompt responses from the Crown.
- **Issue**
    - Did the trial court get it right?
- **Analysis**
    - **Court reasons, on appeal that:**
        - **1) The Minister sufficiently turned his mind to the question of whether the abandoned well qualified as a "producing well" for the purposes of continuation and that it should not be reviewed in this context**
        - **2) That the correspondence from the lessee to the Minister did not qualify as a request for determination as to whether or not the abandoned well would be sufficient for continuation**.
            - In particular, the court notes that the lessee had indicated its intention to drill a new well the year before
            - Therefore, the lessee was not misled to rely on responses from the Minister in order to determine how to continue the lease
    - The minister put his mind to the decision as to whether the well was producing, and thereby capable of extending the lease under s 109 of the Mines and Minerals Act, and made a decision that the well was not a "producing well" within the meaning of the Mines and Minerals Act
        - That decision was eminently reasonable based on the evidence and was the end of the matter
    - **As for whether the Crown is obligated to respond to the lessee's enquiries:**
        - Other evidence shows that the lessee had made representations before that it would drill a new well on the lands, and did not do so.
        - There is insufficient evidence on the record to show that the Crown failed to discharge its duties
- **Holding**
    - Appeal allowed
    - Lease expired and is invalid
- **Ratio**
    - Trial decision is overturned on the basis of lack of evidence to substantiate that the Crown failed in its duty to respond promptly and in good faith the lessee's inquiries as to how to continue the lease
- **Notes**
    - Court reasons, on appeal that:
        - 1) The Minister sufficiently turned his mind to the question of whether the abandoned well qualified as a "producing well" for the purposes of continuation and that it should not be reviewed in this context
        - 2) That the correspondence from the lessee to the Minister did not qualify as a request for determination as to whether or not the abandoned well would be sufficient for continuation. In particular, the court notes that the lessee had indicated its intention to drill a new well the year before
        - Appeal allowed

(b) Reversion on Continuation

Overview

- **Concern**: Large leased blocks of land productive from certain depths with reserves above or below effectively being sterilized

- **Solution**: On continuation of lease (i.e., demonstrated capacity to produce in paying quantities) the deep rights are severed from the lease and revert to the Crown. The same occurs for the rights above the shallowest productive zone (within a specified period of time) → reversion on continuation
    - The Crown can turn around and lease these parts now

(c) Default and Cure and (d) Reinstatement

Mines & Minerals Act – Default, Cure, and Reinstatement

- **S. 8(1)(h)** – Ministerial discretion to extend fixed terms (of lease); even after expiry if in the public interest
    - Might make sense to extend if this lessee company is already there and it's just a matter of time
- **S. 8(1)(e)** – Ministerial discretion to reinstate a surrendered or cancelled agreement if such action is in the public interest
- **S. 45** – Minister's ability to cancel agreements
- Notes
    - Another difference between freehold and crown leases: The amount of discretion

The Ongoing Royalty Discussion

- When is a good time for the government to increase the share of what the government is keeping?
    - Usually in the period of stability at a period of high royalties (2003-2007)
- 2007 Amendment – *Our Fair Share* (+1.4 billion/year + Industry push-back)
- 2010/11 Amendment – rolled back many of the changed
- 2015/16 Modernization for new activity

7. SELECT ISSUES IN RENEWABLE ENERGY

What is Renewable Energy?

- Energy derived from natural processes that are replenished at a rate that is equal to or faster than the rate at which they are consumed
- Examples: Moving water, *Wind, Biomass, Solar, Geothermal,* Ocean energy
- **Hydro**: Transformation of kinetic power into usable energy (turbine blades spin; electrical generator spins)
- **Bioenergy**: Transformation of chemical energy in biological matter (excluding hydrocarbons) into usable energy (wood and wood waste; methane from landfill waste; sewage; manure; alcohols and extracted sugars). Biofuels like ethanol and biodiesel
- **Wind**: Kinetic energy transformed into mechanical energy or electrical energy (see increase, p. 297)
- **Solar**: Radiant heat and energy—passive (building location and design) and active (solar collection and photovoltaic cells)

Rural Landowner Windfalls?

- Opportunity for new lease arrangements with landowners
    - There is high fluctuation/uncertainty in farming – whereas a solar farm will be productive for the full year
    - Certain lease payment/year based on the number of hectares and acres which are being leased
    - Typically, this won't take up their entire farm, just a portion of it
    - Comes with a guaranteed return so long as the company stays solvent
    - Challenges with replacing old kinds of generation with new kinds?
        - Storage – need a way to hold energy when it isn't being produced (e.g. solar energy when it's not sunny)
        - Localization – challenges adapting the grid to meet energy distribution and localized electrical demand
- Potential profits: p. 306
    - Through renewable energy companies – for every 150 megawatts produced, there is a corresponding $17 million in lease payments over a 20-year period
    - Thus, rent would typically be around $15,000 per year for a farmer
- Potential Hurdles?
    - *Surface Rights Act* – does not apply to renewable energy development, so no right of appeal if the lessee runs into financial difficulty

        - Cannot take recourse to an administrative board farmers; have to go directly to the Courts in the case of a dispute
    - No government "orphan wells" program for solar/wind farm projects in the event of insolvency
        - If an O/G operator goes bankrupt, there is a fund to help with that
        - There is nothing analogous for solar companies/wind turbines
    - Nuisances: noise, obstructed views, traffic, neighbourhood disputes
        - Noise associated with wind farms; obstructed views; traffic issues due to maintenance of the equipment
        - If you have a wind farm and your neighbour doesn't there are two claims: 1) nuisances they have to incur; 2) the financial compensation you are receiving over them
    - "NIMBY" effect – "Not in my backyard effect"
        - No one wants one of these right by their home → they have a major effect on property value OR end up being placed by the more marginalized groups in our society

Regulating Renewable Energy Development

- ***Alberta Utilities Commission Act***
    - Extensive regulatory powers
    - S. 17(1) – Public interest decision making regarding Alberta's energy system
        - Under AUC Rule 007, this applies to renewable energy projects (p. 309)
        - Intervenor process for concerned individuals to raise their objections
        - Applicable to private lands, too (p. 310)
    - General approach is to avoid native prairie grasslands (to prevent disruption), although this is possible on private land

AUC Application No. 1606143

- **Background**: Section 9(2) of the *Alberta Utilities Commission Act* sets out how the Commission must determine standing, which involves a two-part test which is considered by the Commission in each proceeding before it.
    - **9(2) If it appears to the Commission that its decision or order on an application may directly and adversely affect the rights of a person, the Commission shall**
        - **(a) give notice of the application in accordance with the Commission rules,**
        - **(b) give the person a reasonable opportunity of learning the facts bearing on the application as presented to the Commission by the applicant and other parties to the application, and**
        - **(c) hold a hearing.**
    - **Essentially**
        - 1) There must be a direct/adverse effect on you as a person or to your property
        - 2) If the commission knows of these people, they must: a) give notice; b) avail them of the facts of the application; c) hold a hearing
- **Facts:**
    - Wildrose 2 Wind Farm Development – was going to be one of the largest in North America; Approval has been issued now; Mr. Walker got standing from the AUC and participated in the hearing → 1) wants the project to be denied; and 2) if it is approved, he wants conditions imposed [only operate during certain hours/days of the year]
- **Main complaints:**
    - a. Environmental Impacts
        - i. Impacts on bats; and
        - ii. Impacts on native grassland area and related species.
    - b. Residential Impacts;
        - i. Heritage concerns;
        - ii. Social impacts;
        - iii. Property value;
        - iv. Visual impact; and
        - v. Noise concerns.
    - c. Economic impacts; and
    - d. Consultation.
- **Decision:**
    - Approved with minimal conditions → community value outweighed Mr. Walkers concerns
- **Takeaway:**
    - Attack all three factors the AUC must consider when attacking this type of decision: 1) Economic; 2) Social; and 3) Environmental
- **Notes**

- Who can lobby to have these projects NIMBY: The wealthy and educated

Leasing Renewables

- A renewable lease is its own beast – often framed as having an option and then a primary term
- **Options + Lease**
  - **Option**
    - Exclusive option to lease the described lands, within 5-year option term
      - Gives the lessee the exclusive option to lease the described lands within the option term for getting their development going.
    - $1000 "option fee" + $1000 "additional consideration" for nuisances/inconveniences each anniversary date
      - Minimal fees to pay too
    - Option can be exercised by writing
    - Automatic termination of option at the expiration of the 5 years, with 90 days for full removal
  - **Lease**
    - Effective from date of receipt of notice
    - What is covered (clause 6)
      - Land description with particulars of the property
    - For how long ("Primary Term") (clause 6)
      - Typically 25 years
    - With renewal (clause 6)
      - Allows for a 2nd primary term
    - Lessee entitlement (clause 7)
      - E.g. If you're a lessee of a solar farm, you have entitlements to protect yourself: easement/access to the panels, uninterrupted access to the sun
    - Payments
      - $500 per Lease Year per acre ("Rent")
      - Paid quarterly
      - Paid based on "estimated rent" which is then adjusted within 30 days of year's end as "actual rent"
      - Rent adjustment in the 6th year, based on the prevailing Consumer Price Index (CPI)
  - **Areas of contention**
    - Renewable energy is 100% voluntary; however, if your neighbor opts for renewable development on their land and you don't, you can suffer some of the consequences without corresponding benefits
      - There is no ability for an operator to force an agreement on a lessor like there is in O/G
      - The corollary is your neighbour can benefit from a development you chose not to undertake and you will then have to deal with the nuisances that arise from it without receiving any compensation – a different kinds of arms race
    - There is no standard form lease, and the leases the companies currently use are generally designed to satisfy the drafter's purposes
      - We're like in the early days of o/g leases
    - More surface land required for solar than wind
    - Wind allows for concurrent use; solar doesn't
    - Options to lease are typically 3-8 years
      - If you're the lessor, you want this to be short as possible
    - Primary terms are commonly 20-60 years
    - Lack of financial oversight (p. 320)
      - Need to be careful doing due diligence on these companies
    - Compensation forms (p. 321) – Possible payment structures could include:
      - Fixed: The landowner would receive a stable annual rental payment.
      - Fixed Plus Variable: The landowner would receive a stable annual rental payment and a royalty based on generation.
      - Variable Only: The landowner would receive a royalty based on generation and no annual rental payment.
    - Valuation over time (p. 327)
      - Do renewable projects increase/decrease over time in their value?
        - It likely increases – it might take years before we know what we can prove or win from a site over a period of time. As long as the technology is upkept, the farms can be more productive as time goes on
      - What about an o/g lease over time?

- Usually decreases – you're drawing from a limited pool; will depreciate over time