CHAPTER 1: ORIGIN, OCCURRENCE AND PRODUCTION OF PETROLEUM AND NATURAL GAS 5
DEFINITIONS 5
HYDROCARBONS 5
GLOBAL MARKET PRICES 6
RECENT CANADIAN REORGANIZATION AND REVENUE DECLINE 6
5 PHASE HISTORY OF CANADIAN/ALBERTAN OIL 6
PRESENT DAY: LOCATING OIL AND GAS 8
CHAPTER 2: OWNERSHIP INTERESTS IN OIL AND GAS SETTLEMENT & TENURE 8
FIRST ORDER OWNERSHIP QUESTIONS 8
IMPORTANCE OF LAND TENURE 8
SETTLEMENT/OWNERSHIP PROGRESSION 8
THE INFLUENCE OF SETTLEMENT OF LAND TENURE 10
Common Land Survey 10
Primer on Duty to Consult and Accommodate 11
Common Law Progression 12
Calder v BC (1973 SCC) 12
R v Sparrow (1990 SCC) 12
R v Badger (1996 SCC) 13
Delgamuukw v BC (1997 SCC) 13
Haida Nation v BC (2004 SCC) 14
Mikisew Cree First Nations v Canada (Minister of Heritage) (2005 SCC) 14
Gitxaala Nation v Canada (2016 FCA) 15
Tsleil-Waututh Nation v Canada (AG) (2018 FCA) 16
Consultation Questions 16
BASIC OWNERSHIP THEORY 17
Borys v CPR & Imperial Oil Ltd (1952) 19
Landowners Mutual Minerals Ltd v Registrar (1952 Sask CA) 20
Land Titles Act 21
Law of Property Act 21
Mines and Minerals Act 21
Borys v Imperial Oil (1953 UKHL) 25
- Petroleum meaning by vernacular test; does not include NG; implied right to work and produce the product despite wasting other substance 25
- Facts: 25
SURFACE ACCESS 27
Cabre Exploration Ltd v Arndt (1986 AB) 27
Surface Rights Act – right of entry 27
Encana Corp v Campbell (2008 ABQB) 28
SOLUTION AND EVOLVED GAS 28
Prism Petroleum v Omega Hydrocarbons (1994 ABCA) 28
Anderson v Amoco Canada Oil and Gas (2004 SCC) 29
Evolved gas; hydrocarbon entitlement determined by phase at the time of transaction, meaning initial reservoir conditions 29
- Background: 29
GAS OVER BITUMEN 30
Alberta Energy Co v Goodwell Petroleum Corp (2003 ABCA) 30
Gulf Canada Resources Ltd Request for Shut in, Surmount Area (2000, EUB) 32
Authorization of an Agreement Between the Crown and Conoco Canada Resources Ltd et al (OC 83/2002) 32

COALBED METHANE 33
Amoco Production Co v Southern Ute Indian Tribe (1999, USSC) 34
Re Bearspaw Petroleum Ltd (2007, AEUB) 35
Legislated Clarification 35
Mines and Minerals (CBM) Amendment Act, 2010 35
Coalbed Gas Act, 2003 36

STORED GAS 36
Hammonds v Central Kentucky Natural Gas Co (1934 KY Ct App) 37
Not liable in trespass for injecting gas under someone's land; gas ceased to be injector's property; Oklahoma wild animal theory 37
- Facts: 37

Lone Star Oil & Gas v Murchison (1962 Tex Ct Civ App) 37
Mines and Minerals Act 37

CARBON CAPTURE AND STORAGE 38
Berkheiser v Berkheiser (1957 SCC) 41
IFP Technologies v EnCana Midstream and Marketing (2017 ABCA) 42

SUBSURFACE DISTURBANCES 42
BLOWOUTS 42
Elliff v Texon Drilling Co (1948 Tex Sup Ct) 42
Atlantic Claims Act, 1949, the Regulator's Role, and the Settlement Process – Alberta Approach for Blow Outs 43
Lodgepole Amoco Sour Gas Blow Out, 1982 44
Interim Guidelines for Resident Compensation, 1989 44
GEOPHYSICAL EXPLORATION 44
Phillips Petroleum Co v Elliot F Cowden (1957 US 5th Cir) 45
Mines and Minerals Act 46
Exploration Regulation 284/2006 (M&M Act) 46
Phillips v California Standard Oil Co (1960 ABSC) 46
Wassan v California Standard Oil (1964 ABSC) 47
HYDRAULIC FRACTURES 47
Coastal Oil & Gas Corp v Garza Energy Trust (2008 Texas) 47

CHAPTER 3: ACQUISITION AND CONVEYANCING OF INTERESTS IN OIL AND GAS *48*

WHEN DOES A "LEASE" MEAN A PNG LEASE? 48
Law of Property Act, "Part 7: Mineral Titles Clarification" 49
Hayes v Mayhood (1959 SCC) 49

LIFE ESTATES 50
Re Moffat Estate (1955 Sask QB) 50

PERPETUITIES 51
Canadian Export Gas & Oil Ltd v Flegal (1997 ABSC) 52
PanCanadian Petroleum Ltd v Husky Oil (1994 ABQB) 52
Pan American Petroleum Corp v Potapchuk (1994 ABSC) 53
Scurry-Rainbow Oil (Sask) Ltd v Taylor (2001 SKCA) 54

CHAPTER 4: THE FREEHOLD LEASE *55*

OVERVIEW 55

ANATOMY OF THE PNG LEASE 55
(1) The Granting Clause 55
(2) The Habendum Clause 56
Habendum Proviso 1: Delay Rental Clause 57
Habendum Proviso 2: The Dry Well Clause 58
Habendum Proviso 3: The Continuous Operations Clause 58
(3) The Shut-In Well Clause 59
(4) The Offset Well Clause 60

(5) Pooling Clause 60
(6) Default Clause 60
(7) Manner of Payment Clause 61
Lessor's Compensation Package 61

1. THE DELAY RENTAL CLAUSE 62
Paddon Hughes Development Co v Pan Continental Oil Ltd (1998 ABCA) 62

2. THE HABENDUM & CONTINUOUS OPERATIONS 63
Canadian Superior Oil Ltd v Crozet Exploration Ltd (1982 ABQB) 63
Canada-Cities Service Petroleum v Kininmonth (1963 ABSC; 1964 SCC) 64
Sohio Petroleum Co v Weyburn Security Co (1971 SCC) 65
Cull v Canadian Superior (1972 SCC) 66
Canadian Superior Oil v Murdoch (1969 ABQB) 67
Canadian Superior Oil v Paddon-Hughes/Hambly (1969 ABQB) 68
Republic Resources Ltd and Joffre Oils Ltd v Ballem (1982 ABQB) 69

3. PRODUCTION 71
Clifton v Koontz (1959 US Texas SC) 71
Omers Energy v Alberta (ERCB) (2011 ABCA) 71
Bearspaw Petroleum Ltd v Encana Corp (2011 ABCA) 72

4. THE SHUT-IN WELL CLAUSE 73
Kissinger Petroleum Ltd v Keith McLean Oil (1984 ABCA) 74
Durish v White Resource Management Ltd (1987 ABQB) 75
549767 Alberta Ltd v Teg Holdings Ltd (1997 ABQB) 76
Freyberg v Fletcher Challenge Oil & Gas (2005 ABCA) 76
Kensington Energy Ltd v B&G Energy Ltd (2008 ABCA) 77

5. OPERATIONS UNDER AN INVALID LEASE 78
Champlain Refining Co v Aladdin Petro Corp (Okla Sup Ct 1951) 79
Sohio Petroleum Co v Weyburn Security (1971 SCC) 80
Montreal Trust Co v Williston Wildcatters (2004 SKCA) 81
Freyberg v Fletcher Challenge (2007 ABQB) 83
Stewart Estate v TAQA North (2015 ABCA) 84
Trespass and conversion are the right causes of action; leading case in AB but different than Sask; supports mild rule as fair and just determined by net operating income; closes the door on the harsh approach 84
Xerex Exploration v Petro-Canada (2005 ABCA) 86
International Corona Resources Ltd v Lac Minerals Ltd (1986 Ont; 1989 SCC) 87
Republic Resource Ltd v Ballem (1982 ABQB) 87

6. THE ROYALTY CLAUSE 89
Overview 89
Acanthus Resources v Cunningham (1998 ABQB) 91
Canpar Holdings Ltd v Petrobank Energy & Resources Ltd (2011 ABCA) 92
As a matter of interpretation and use, royalty should be paid for fuel gas as well; used compensatory method 92
- Facts: 92

CHAPTER 5: THE NATURE OF ROYALTIES 93

THE NATURE OF ROYALTIES 93

ROYALTIES IN GENERAL 93
Bensette v Reece (1969 SKCA) 93
Emerald Resources v Sterling Oil (1969 ABSC) 94
Saskatchewan Minerals v Keyes (1972 SCC) 95

ROYALTY TRUST AGREEMENTS (RTAS) 95
Guaranty Trust v Hetherington (1989 ABCA) 96
Scurry Rainbow v Galloway Estate (1994 ABCA) 97
Bank of Montreal v Dynex Petroleum (2002 SCC) 98
Third Eye Capital v Dianor Resources Inc (2018 ONCA) 98

CHAPTER 6: CROWN DISPOSITIONS ____ *99*

INTRODUCTION ____ **99**

ALBERTA'S TWO-TIER SYSTEM ____ **99**

ASPECTS OF LEASES/LICENSES ____ **101**

[1] Continuation ____ 101

Industrial Coal & Mineral Ltd v Alberta (1977 ABSC) ____ 101

[2] Reversion on Continuation ____ 102

[3] Default, Cure and Reinstatement ____ 102

CHAPTER 7: SELECT ISSUES IN RENEWABLE ENERGY ____ *103*

CHAPTER 1: ORIGIN, OCCURRENCE AND PRODUCTION OF PETROLEUM AND NATURAL GAS

DEFINITIONS

- **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, AB has the second largest petroleum reserves in the world (second to Saudi Arabia)
    - Bitumen content by percent weight varies – deposit containing in excess of 12 percent bitumen is thought to be rich, less than 6 percent is considered less viable
- **Oil sands mining:** mostly completed by open pit mining
    - The overburden is stripped and stored for future reclamation, scoops of sand are extracted into trucks, entered into a separation process at the extraction point, upgraded (by splitting or cracking the bitumen), and shipped to refineries
    - Creates a sweet synthetic crude oil, and land reclamation occurs after the 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 injected into the upper wellbore, heating the deposit and allowing the bitumen to drain into the lower well, where it is then pumped to the surface
- **Shale gas:** refers to natural gas (mainly methane) found in fine-grained, organic-rich rocks (gas shale)
    - 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 material
- **Liquified natural gas:** natural gas cooled to the point where it condenses into a liquid
    - Can be stored and shipped safely because its colourless, odourless and non-toxic
- **Conventional vs unconventional gas:**
    - Conventional: has tendency to flow, simpler to extract. Flows easily from area of high pressure to low pressure
    - Unconventional: must be separated (oil sands) or fractured (gas)
        - Low viscosity, low propensity to flow
        - More expensive to extract, requires more investment of energy and resources
- **Crude oil:**
    - Light vs heavy: refers to viscosity, specific gravity and API gravity – describes how dense the crude is and its relative density to water
        - Can also be distinguished on the hydrocarbon chains in them – denser will have longer chains, lighter will have shorter chains
        - Light has more tendency to flow than heavy – it is more desirable because it's less work (e.g. West Texas Intermediate)
    - Sweet vs sour: refers to sulphur content as an impurity
        - The more impurities render it less efficient to burn and more polluting, so a less desirable substance
        - Best product is light, sweet crude
- **Fracking:** essentially fractures the layer of sediment, then a high velocity substance is inserted to open up the fissures in the sediment. The liquid put in is pumped out while the other substances are left to keep the fissures open so the gas can be extracted
    - Called "tight gas" because its stuck in pockets

HYDROCARBONS

- Various "fossil fuel" forms: crude oil, bitumen, natural gas, coal
- **Standard metrics:**
    - Oil production: 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 access and then put to work (heat, drive, power, etc.) through the process of combustion

GLOBAL MARKET PRICES

- **Pricing vocabulary**
  - Brent Crude (Brent):
    - North Sea Crude – helps set African/European/Middle East prices
  - West Texas Intermediate (WTI):
    - North American benchmark for pricing
    - Traded on New York Mercantile Exchange and Chicago Mercantile Exchange
    - Our products are measured in terms of a differential as compared to WTI
    - Texas sweet (low sulfur); light (low density/wax)
  - Western Canadian Select (WCS):
    - Heavy crude (including bitumen) mixed with diluents
    - Initiated in 2004
    - Priced lower than WTI where traded because (1) location – transportation costs (2) energy and cost needed to upgrade
- **A suite of factors affect global oil and gas prices within supply and demand markets, such as:**
  - The strength of national economies
  - New unconventional sources (e.g. American shale oil/gas)
  - OPEC and its production quotas
  - Geopolitical instabilities
- **Influence of oil trade**
  - Oil is one of the most intensely traded commodities and its trading price impacts other commodities – also influences the global economy
  - Trade on future contracts:
    - Means buyers and sellers coordinate and agree to deliver specified amounts of crude to a specific location, at a future date, at an agreed price
    - Each contract, covering 1000 barrels, allows participants to establish delivery dates 9 years in the future
    - During the delivery month the seller must deliver the oil to the buyer at the Cushing, Oklahoma energy hub

RECENT CANADIAN REORGANIZATION AND REVENUE DECLINE

1. Bitumen bubble:
   - In the oil sands region we can produce more than we currently have the ability to export, so there is a constant push to get more export avenues
   - Excess production that does not get to market is stockpiled
2. USA does not need our natural gas:
   - Burgeoning shale gas and tight gas industry in the US
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
4. USA is not necessarily open to Canadian supply (Keystone):
   - Environmental problems, virtue signalling, etc.
5. Export market expansion is slow

5 PHASE HISTORY OF CANADIAN/ALBERTAN OIL

1. **Prior to 1946**
   - Dingman Well in 1914 often pointed to as one of the earliest productive wells, produced light crude in an amount that exceeded local needs
   - Turner Valley boom – more and more oil and gas produced, around this time oil and gas in North America took off – boom in Texas and Oklahoma
   - After WWI: Treaty of Versailles allowed the owners of BP to end up with massive mineral rights very cheap in the Middle East
     - This ceded some of the east-west tension in the Arabian Peninsula
2. **1946-1972: oil but no market**
   - In 1946 oil was discovered in Canada (Leduc – Turta farm), but there was no huge rush for it, slightly more expensive
     - Wildcatting approach produced over 125 dry holes before they ultimately struck the right point in the Nisku reservoir
   - 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 the use of Canadian oil in the west
  - Enacted under the fed trade and commerce power (upheld in *Caloil v Canada*, SCC 1971)
- Gas was also being produced at this time but there was little demand for it – seen as an annoying by product
- 1958: pipeline debate on a national scale regarding whether the government would build a Trans Canada pipeline

3. **1973-1981: OPEC crisis**
   - 1973: price of oil didn't change between 1946-1972, mentality was that the price would never really change
     - Then OPEC gained power, upset with the unfair concession agreements and resentments because of political and economic control by the west, they started to choke off supplies until the price rose (went from $3 to $12/barrel)
     - Precipitating factors included war with Israel backed by western powers
   - OPEC's increase of oil prices (and limiting of supply) began to create substantial inflation across the global economy
     - Increase in prices from the Middle East allowed for AB to be more competitive with the prices being charged
     - Suddenly the value of AB oil was rising and AB became an energy-based economy
   - AB legislature decided that existing **fixed royalty rate** is abolished – went from 12.5 percent to 50 percent
   - The rest of Canada was suffering from vast inflation, which started a sense of national resentment towards AB
   - Mid 1970s: economic nationalism was rampant in Canada
     - Fear over foreign ownership
     - Fed government began taking an interest in oil
     - 1975: Petro Canada established as a national champion
4. **1980s: federal response (NEP/OPEC price collapse)**
   - 1980 NEP (National Energy Program)
     - During the boom of 1973-1981 AB became wealthy, but the tension it produced led to the creation of the NEP
     - Goal was self-sufficiency in terms of oil supply, increase in 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 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
     - Refineries were given subsidies to cover the difference between world and national prices
     - For every foreign company that held Canadian lands, the fed government was allowed to take back 25% of their interest without compensation
     - Overall: brought the industry to a crashing halt because it was no longer worth it to produce, which meant the government didn't get the revenues it expected
   - OPEC pricing collapse ends up in a flooding of the market
   - Price spike in 1982 (Iranian Revolution) which ends up further flooring the market
5. **1984: market direction**
   - Mulroney elected in 1984, 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
     - Pre-1986: export restrictions, resulted in a reduction of exploration
     - These restrictions were established in 1986, Canadian producers allowed to exploit highest domestic or international price of oil
   - 1990s: Alliance pipeline (AB to Chicago) transported massive amounts of natural gas
   - 1991/1992: Iraqi invasion of Kuwait (first gulf war), short spike in oil prices
     - Remainder of 1990s fairly steady decline in the price of oil until 2000
     - World suddenly realizes we have a large supply of oil so prices drop and people get accustomed to cheap energy
   - 1996: federal/provincial government created an incentive scheme for production of oilsands
     - Scheme was put in place where the government modified its tax/royalty scheme to allow for new oilsands to be made
6. **2000: new technologies and consumers**
   - 2000s: significant increase in consumption (China and India develop as emerging markets)
     - Geopolitical events: 9/11 and invasion of Afghanistan and Iraq, and incredibly hostile regime in Iran – after this people realized how vulnerable oil production was
     - Higher oil prices brought about an emergence of technology
       1. Directional and multi-well drilling, as well as hydro-fracking
       2. Production of shale gas wells has led to a reduction in both oil and natural gas prices

        - Appears that North America is returning again to an abundance of oil and gas
    - 2007-2008: oil prices spike at $147/barrel
        - Conservation efforts focus on energy efficiency

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
    - Oil and gas: oceanic/deep water
- **Exploration**
    - Surface conditions hint at subsurface features (ridges, folds, indentations)
    - Seismic 3D imaging reveals reservoirs, then exploratory wells are drilled
        - Note: significant sunk costs in finding the resources and drilling before any extraction takes place
- **Oil and gas traps**
    - Gas is less dense than oil so it will always rise to the top of a reserve and create a gas cap
    - An oil and gas reservoir is permeable rock – a productive oil well is going to come from a porous level of rock (the more porous, the more ways of communication and the better it will be)
- ***Crozet Exploration Ltd***
    - Shows the ways in which oil and gas timelines can become complicated in a legal scenario
    - Certain activities have to happen by a certain moment in time for the contracts to be valid
    - This case shows how oil and gas companies have to move quickly to meet those timelines
- **(Proven) world energy reserves**
    - Crude oil: 2011 – 1476 barrels; 2020 – 1730 billion barrels
    - Natural gas: 6708 trillion cubic feet; 2020- 7000 trillion cubic feet
    - Canadian oil reserves: 171 billion barrels (95% in oil sands)

CHAPTER 2: OWNERSHIP INTERESTS IN OIL AND GAS SETTLEMENT & TENURE

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 in AB?
3. How do we reconcile development that is occurring on or surrounding FN's traditional lands with constitutionally protected rights and obligations?

IMPORTANCE OF LAND TENURE

- **Land is needed for exploration and to mine/drill**
    - Boils down to "who owns what?"
- **Currently in AB:** 81% of mineral rights are held by the province; 10% in freehold; remainder federally "owned" (national parks and reserves)
    - We focus on the 10% in freehold and the lease agreement
- **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 transactions
    - We have the Torrens land system in AB
- **Fee simple:** essentially full ownership regarding the 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 to 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 Hudson's Bay*
- ***Royal Proclamation, 1763*: Indian lands (*Calder*, SCC 1973)**
    - 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 (restriction on alienation)
- No cede and surrender by the FN except to the Crown
- ***Calder:*** the Royal Proclamation applies west of the Rocky Mountains – no alienation except to the Crown

- **1867: Confederation (*British North America Act, 1867*, s 109)**
  - **Sec 109**: all land, mines, minerals, and royalties belonging to the provinces of Canada, Nova Scotia…shall belong to the provinces in which the same are situate or arise, subject to any trusts existing thereof and to any interest other than that of the province in the same
    - Ownership given to the provinces – will become an issue when other provinces like AB join
    - Early trade off was that the first provinces end up with ownership of below surface title – one of the early ways in which provinces could assert autonomy
- **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 fertile belt (large swath of land throughout 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 private mineral ownership**
- **1871: Canadian Pacific Railway (land grants)**
  - **Second major way** we see private mineral ownership
  - Canadian gov't grants to CP ownership both surface and subsurface lands 25 miles around the track
  - CP can now start selling this land to finance further development
- **Homesteaders** (land grants: until approximately 1887-1889, mineral rights included)
  - Grants given by fed gov't to individuals on the promise that they would work the land
  - Gov't then realized the value of the land 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 less subsurface title that was included in the transaction
- **Treaties** (i.e. with Plains and Wood Cree, 1876)
  - Cede and surrender of lands
- ***Soldier Settlement Acts* (1917 and 1919)**
  - Two different pieces of legislation from the end of WWI
  - Trying to reward people who served in Canada (similar to a pension), gave land to people who came back from the war
  - Sometimes the land came with both surface and subsurface title – *could lead to private ownership*
- **Manitoba (1970), Sask (1905) and AB (1905) become provinces; resource ownership disparity quickly realized and contested**
  - Sec 109 didn't include these new provinces
- **1930 resource transfer** (significantly caveated) to regularize Canada's original provinces
  - Tried to put new provinces in the same position as older ones
  - *An Act Respecting the Transfer of the Natural Resources of Alberta* – transferred all mineral rights (other than fed parks and Indian reserves) to the provinces subject to the restrictions in the BNA Act
  - This Act included two exceptions:
    - (1) Provinces have to respect the existing federal grants and not affect them except with the consent of the grantee or except insofar as any legislation may apply to all similar agreements relating to lands, mines and minerals in the province
      - I.e. mining leases – heavily litigated, but not a big problem now because a lot of these grants expire after 25 years
    - (2) Each province was required to set aside enough land to allow Canada to fulfill its outstanding obligations under Indian treaties
  - Issue: individuals ended up asserting that they had title to private ownership prior to the government executing this transfer
- ***Constitution Act, 1867* ss 92(a)**
  - Tried to solidify provincial ownership of natural resources

6 Exceptions to Provincial Crown M&M Ownership

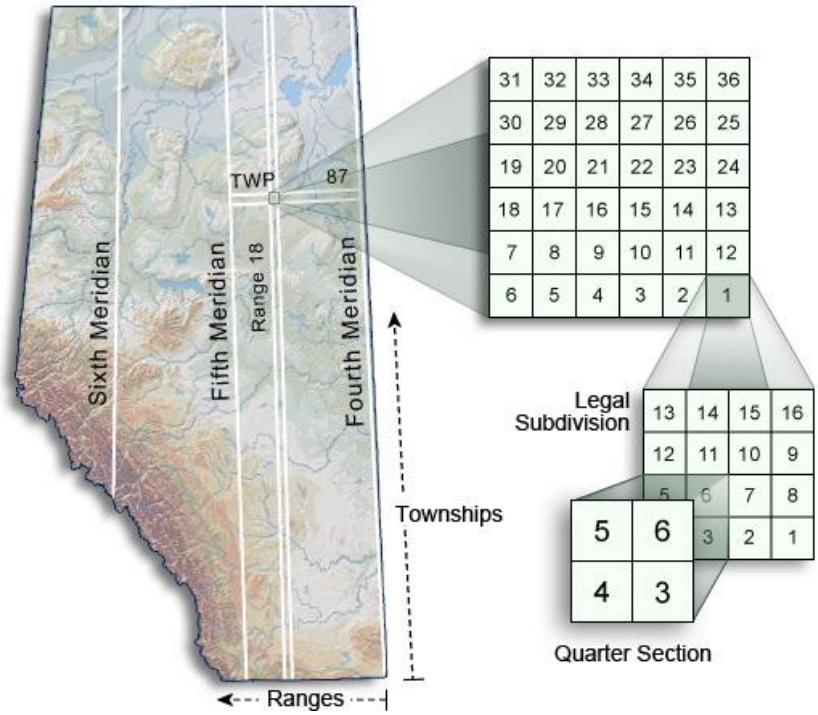
1. HBC ownership
2. Railway ownership
3. Homesteader ownership (pre-1887-89)
4. Unique legislation (*Soldier Settlement Act* of 1917 and 1919)
5. Federal: Indian Reservation Land/ National Park Land
6. Lingering claims under the *NRTA* (Natural Resource Transfer Agreements)

Federal Government Involvement

- Interprovincial commerce has kept the fed gov't in the energy picture (1956: National Energy Board created, s 19(2))
    - We know that interprovincial commerce is federal jurisdiction
    - Note that NEP has since been replaced by the National Energy Regulator (created over a year ago)
- NEB completes environmental assessments and recommends approvals for major infrastructure projects
- Fed government is involved re: climate change legislation
    - NOTE: any time you are looking to transfer oil over provincial boundaries the Trade and Commerce power (fed power) in the *Constitution* may be a factor
        - This is the most important power the fed gov't has in regard to oil and gas production
        - The only solid legal ground the provinces could fight back on against something like the NEP is though the amount of production, as this is the ability of the owner to do so
        - But today, the fed govt's interest in energy production is primarily environmental (e.g. 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

THE INFLUENCE OF SETTLEMENT OF LAND TENURE

Common Land Survey



- Meridians = lines of longitude
    - 4th meridian line runs along the barrier between AB and SK
    - 5th meridian line runs west of Edmonton and transects through Calgary
    - 6th meridian line runs through Jasper
- Ranges = lines between meridians
- Townships = squares that form between townships and ranges
    - Each township is 6 x 6 miles
- Sinusoidal numbering – numbering within a township, done for ease of creating a pattern
    - Mimics the way the land surveyors would have walked
- Breakdown:
    - A township is 6 x 6 miles
        - 36 square miles
    - Within 1 township there are 36 sections
        - Each section is 1 x 1 mile

- Within 1 section there are 16 legal subdivisions (also sinusoidally ordered)
- 16 legal subdivisions are divided into 4 quarter sections
  - Each quarter section is ½ mile x ½ mile

Alberta's Township Survey System

- Applicable to Manitoba, Saskatchewan, Alberta and Northeast BC
- Situated using longitudinal meridians and latitudinal parallels
- Baseline is 49th parallel (Canada-US border)
- New East-West baseline set every 24 miles north, with a correction line every 12 miles
  - Need to account for curvature of the Earth
- Range road allowances every 6 miles
  - Allows for different sources of access
- Measured against meridian lines
- Sinusoidal organization of sections and 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 with 25 miles of railway, save section 11 and section 29
  - A lot of land, but very narrow belt

Range (column of townships) ➡Township (6 m2)➡ 36 sections (1 m2) ➡Legal subdivision (16 subdivisions; 4 constitutes a ¼ section)

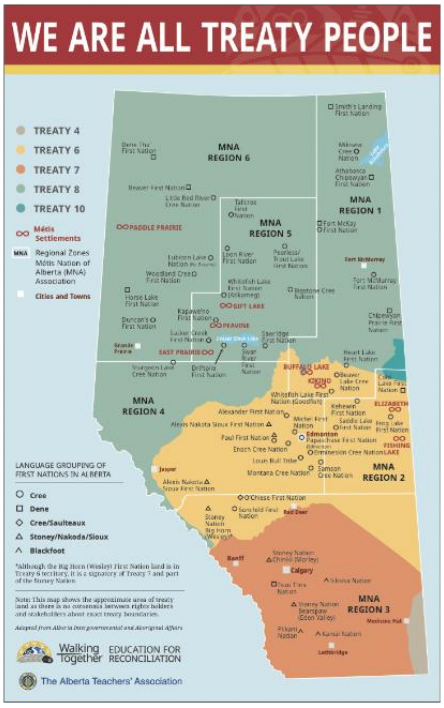
Numbering: L.S A of B-C-D-WE

- A = legal subdivision
- B = section
- C = township
- D = range
- E = meridian (4/5/6)

Where to calculate from: eastern and southern edge

Primer on Duty to Consult and Accommodate

Treaty Lands



- Remember – FN are not one identifiable group, hundreds of different communities with different customs and experiences

- We are talking primarily about Treaties 6, 7 and 8
  - Treaty 6: conventional oil development
  - Treaty 8: oil sands development
  - Some overlap from other areas

Aboriginal Rights

- **Common law (pre-1982) ➡ Constitutional (post-1982)**
- Can be two types of treaty rights:
  - (1) Freestanding right (recognized at CL); or
  - (2) A treaty right
- Before 1982: Aboriginal rights existed through the CL
- 1982: **Constitutional enshrinement** of protection of Aboriginal and treaty rights through **section 35**
  - (1) *The existing aboriginal and treaty rights of the aboriginal peoples of Canada are hereby recognized and affirmed*
  - Definition of "aboriginal peoples of Canada"
    - (2) *In this Act, "aboriginal peoples of Canada" includes the Indian, Inuit and Metis people*
- Recognition as a constitutional right bought the right into a higher order (highest in Canada)
  - But 1982 rights did not "bring back" rights that had been previously extinguished
- 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 Rocky Mountains

Facts: Appellants, suing on their own behalf and on behalf of other members of the Nisga'a Tribal Council brought an action against the Attorney General of BC for a declaration that "the aboriginal title, otherwise known as Indian title, of the plaintiffs to their ancient tribal territory…has never been fully extinguished"

- Nisga'a title claim to 2,600 square kilometers in NW BC
- The action was dismissed at trial and the CA 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
- Opens the door to considering future title claims/aboriginal title and land claims agreements

Note:

- Aboriginal title is a form of an Aboriginal right – how does it differ?
  - Traditional rights (hunt, gather, etc.) are collectively held but **individually** exercised
  - Aboriginal title is different – it is a collective right that implies **collective action**/collective governance decision-making
- It is a suis generis right

***R v Sparrow* (1990 SCC)**

Confirms that the rights that received constitutional protection were not those extinguished prior to 1982

Facts:

- Musqueam food fishing license dictated by *Fisheries Act*. Band members charged with offence of fishing with net longer than permitted by the license
- Defence: exercised existing aboriginal right to fish and net length restriction is consistent with s 35, so therefore valid
- Case where there is a contest between environmental law and regulation, vs 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 restriction in the license 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 the Crown must demonstrate that regulation is justifiable

Reasons:

- **Sparrow test for 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? Plain and clear 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

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
- Even if you can prove the existence of a right, there is still a way the right can be infringed upon as long as it's justified

R v Badger **(1996 SCC)**

Treaty right to hunt can be limited by gov't action for issues around safety or conservation if unoccupied and not put to visible use

Historical background:

- Treaty 8 right to hunt guaranteed subject to gov't taking up for valid objectives and regulatory actions
    - Limited geographically and by gov't regulation
- 1899: Treaty 8 was signed, surrendering portions of northern BC, AB, Sask and NW Territories. Part of the agreement included a guarantee of the right for Indians to continue to 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 of commercial resource extraction, and subject to regulation for conservation
- 1930: Para 12 of *NRTA* confirmed the rights of Indians to hunt

Facts:

- Three individuals all had status as Cree Indians under Treaty 8. All admitted to shooting moose on privately owned lands within Treaty 8 territory (one under the Wildlife Act, two with hunting without a license)
    - All challenged the constitutionality of the provisions for infringement of their s 35-protected Treaty 8 rights
- Dismissed in ABCA on the grounds that the *NRTA* had extinguished Treaty 8 rights, and those rights did not apply on private land regardless

Issue:

- Whether Treaty 8 right to hunt still existed, or if it had been extinguished or replaced by the *NRTA*. If it did exist, could it be exercised on private land?

Holding:

- **The NRTA does NOT extinguish the Treaty 8 right to hunt for food**
    - While it does limit and alter the hunting rights under Treaty 8, it does not extinguish that right – to do so requires *plain and clear 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 is not compatible with the right to hunt*
    - **Where land is occupied (visible, incompatible use) there is no right of access to hunt**
- Case ended up with different results:
    - In one hunting situation there was clear evidence of occupation and signage indicating it was private land being put to use - excluded from the right to hunt
    - In the other, it was in a bog - not the same structures or clear signage, so it was appropriate to be accessed for the purposes of hunting

Ratio:

- Test: *unoccupied + not put to visible use*

Delgamuukw v BC **(1997 SCC)**

Test for Aboriginal title- suis generis right and interest in land; consultation required to justify interference with Aboriginal rights

Facts:

- Gitxsan and 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

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

- **What is the content of aboriginal title?**
    - Aboriginal title encompasses the 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 uses of the land within the inherent limit
- **General features of aboriginal title:**
    - **Suis generis:** must be understood through CL and aboriginal perspectives
    - **Inalienability:** cannot be transferred, sold or surrendered to anyone but the 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 afterwards
    - **Communally held:** collective right to land held by all members of FN group. 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
- **Test for title:**
    - (1) Occupied prior to the assertion of Crown sovereignty
    - (2) Exclusive occupation
    - (3) Continuous occupation (oral history with equal evidentiary value)

Ratio:

- Aboriginal title as a suis generis interest in land
- Affords the right to exclusive use and occupation, and the right to choose the use the land is put to. Inalienable, except to the Crown
- Compensation payable if title infringed – based on *Sparrow* test
- Where it exists (or may exist), DTC is engaged prior to action/decisions affecting it
- Elucidates a test for title; difficult to meet

Haida Nation v BC **(2004 SCC)**

DTC when Crown has real or constructive knowledge of potential aboriginal right claim and action contemplated that will have adverse effects

Facts:

- Province unilaterally decided to change and redistribute tree farming licenses over land where Haida claims title

Analysis:

- **Duty to consult:**
    - The DTC is grounded in the principle of honour of the Crown (fiduciary relationship)
    - 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 is reciprocal
- **Scope and nature of duty:**
    - Consultation and resulting accommodating exists *along a spectrum* – the more critical the right the stronger the claim, and the greater the potential adverse impact the greater the degree of consultation expected

Holding:

- Gov't had duty to consult with and accommodate Haida with respect to harvesting timber on lands where Haida had claimed title

Ratio:

- Sets down what is required to uphold the honour of the Crown, engaged by s 35 and Crown's fiduciary obligations
- Constitutional duty to consult 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

Mikisew Cree First Nations v Canada (Minister of Heritage) **(2005 SCC)**

DTC also applies to infringement of treaty rights and exists on a spectrum; low infringement requires lower level of consultation

Facts:

- Mikisew Cree were among the FN who lived in areas surrendered under Treaty 8 – in exchange for the land they received the right to hunt, trap and fish in the 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 fed gov't approved a winter road that would run through their reserve. They were not consulted despite their protests and potential impact on guaranteed treaty rights
- Fed Court of Appeal – found the building of the road was properly a "taking up" of surrendered land in accordance with Treaty 8, so not an infringement

Analysis:

- DTC was triggered
  - The impacts of the proposed road were clear, established and adverse to the continued exercise of the Mikisew Treaty 8 rights
- Extent of the DTC
  - DTC exists on a spectrum and all relevant factors should be considered when determining the extent of consultations required to fulfill the duty
  - Because the road is considered minor and would be built on surrendered lands where the rights were *expressly* subject to a taking up provision, the consultation required would be at the lower end of the spectrum
    - But still must provide notice and engage directly
  - **Crown must demonstrate an "intention of substantially addressing aboriginal concerns…through a meaningful process of consultation"**
- Crown did not fulfill this obligation
  - Crown unilaterally declared the road re-alignment and did not engage in any dialogue with the Mikisew that would demonstrate a good faith interest in addressing their concerns

Holding:

- Minister's approval of the road project quashed (project set aside); Crown must consider the impact the "taking up" would have on the treaty rights and address these issues by consulting in good faith

Ratio:

- DTC applies to treaty rights, not just aboriginal rights and title
- "Taking up" requires consultation – we need *modern, contemporary consultation,* look at the **current state of affairs** and determine from this what the Crown has to do presently to discharge its obligations

***Gitxaala Nation v Canada* (2016 FCA)**

Environmental impact assessments can be used to discharge DTC; aboriginal group must be reasonably satisfied, perfect satisfaction is not required

Background:

- In 2005 Enbridge Inc approached the 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 AB to the BC coast
- To review the application, Canada created the joint review panel
- CEAA outlined a 5-phase consultation plan in order to discharge the Crown's DTC and accommodate aboriginal interests
- 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; the first three phases were extensive, but the post-report phase was completed with minimal consultation
- The Gov in Council approved the project; some Aboriginal groups disputed the decision – they sought to have the order approving the project quashed, that it was unilaterally imposed, over delegated, inadequately funded, ignored some issues, was too generic – overall that Canada failed to share its legal assessment of the strength of affected aboriginal rights

Analysis:

- **Duty to consult**
  - The DTC is guided by the process of reconciliation and need for fair dealing – arises when the Crown is aware of the *potential* existence of an aboriginal right or claim to title
  - *Continuing duty:* expected that throughout the permitting, approval and licensing process the Crown fulfills its DTC
- **The Crown failed to communicate its view of the strength of the aboriginal claims**
  - In the later consultation phases the Crown refused to provide aboriginal groups with any official statements of information concerning its view of how strong it thought their affected rights and title claims were
  - Info should have been shared with affected 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 was inadequate:
    - Deadlines on consultation cannot be arbitrary and unjustified
    - Aboriginal concerns must be directly addressed and substantively responded to (even if ultimately dismissed)

Holding:

- Quashed the order in council directing the NEB to issue the necessary certificates to begin construction
- Options: redo final phase of consultation or decide not to seek approval again

Ratio:

- Re-states existing jurisprudence on consultation
- Recognizes that environmental impact assessments can be used to discharge the duty (*Taku River*)
- Articulates the standard (reasonable satisfaction, NOT perfection)
- Consultation doesn't guarantee an outcome, only a process

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
  - Application for offshore seismic testing granted by NEB
  - NEB concluded that the proponent had conducted adequate consultations with the affected FNs and given them adequate opportunity to participate
  - Holding: NEB failed to discharge its constitutional obligations with FN communities
- ***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 FNs had been adequately consulted
  - Holding: FNs had not been adequately consulted
- Overall: these cases show that the consultation duty is owed by the Crown (personification of the monarch, but also the executive function that exists
  - While the Crown may rely on a regulatory process to discharge its constitutional 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 process to the Northern Gateway (*Gitxaala*)

Analysis:

- Court recognized that the gov't made improvements compared to the Northern Gateway process
- Ultimately failed because in a phase similar to Phase IV in *Gitxaala*, the gov't sent gov't officials back before the Governor in Council made a final decision
  - The court reviewed the consultations and determined that they still fell short of the mark
  - Must be a *dialogue in good faith* with the potential for meaningful outcomes
  - In this phase it was not a dialogue – reduced to *mere note taking*
  - The officials didn't respond or move the concerns forward in a way that would satisfactorily be addressed

Ratio:

- Consultation process must be a two-way dialogue in good faith with the potential for meaningful outcomes

Consultation Questions

Consultation or consent?

- **UN Declaration on the Rights of Indigenous Peoples:**
  - **Art 32:** states shall consult and cooperate in good faith with the indigenous peoples concerned through their own representative institutions *in order to obtain their free and informed consent prior to the approval of any project affecting their lands or territories or other resources*, particularly in connection with the development, utilization or exploitation of mineral, water or other resources
  - Some have incorporated the provisions of this declaration into domestic provisions, but Canada reserved its support to a number of provisions
    - Those that mentioned "free and informed consent"
    - We know consent isn't a general requirement of the DTC – it guarantees a process, not an outcome
    - Only the most limited circumstances reserved for very significant infringement where consent might be required
- **Canada DTC**:
  - 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)
  - Consultation duty does not extend to the legislative process (limited to consultation) (*Courtoreille v Canada,* 2017)
    - FN communities can't argue that the legislative process that resulted in a law was flawed because it didn't get the requisite consultation – SCC has said this is a separate process

- But it DOES extend to high level policy decisions – e.g. coal leases in Grassy Meadows

Consultation requirements

- Depth of consultation differs according to strength and nature of the aboriginal claim
- 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 (accommodation meant to flow from consultation)

When is the DTC triggered?

- Where gov't 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?

- DTC is restricted to aboriginal people
  - Those who can make a strong prima facie case that they hold rights in the affected area
  - There is a need to show a nexus between the proposed activity and the affected right

What is proper consultation?

- No unreasonable timelines imposed
- Gov't positions and decisions properly explained
- Aboriginal concerns considered and addressed
- Crown deals reasonably and takes aboriginal rights seriously
- No "sharp dealing" (bad faith negotiations)
- Can take place as part of the environmental assessment process (*Taku River,* 2004)
  - Admin body can play a large role, but the ultimate responsibility still rests with exec and higher level of gov't

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 (including traditional knowledge)
- Consider financial assistance to allow effective consultation
- Evidence of a genuine willingness to modify a project in light of concerns
- Accommodate FN interests wherever possible

Impact benefit agreements

- Secure the support (or non-objection) of FNs
- Provide continuing consultation during construction and operation of project in interests of long-term harmony
- Avoid mere cash payment of a cash bonus, focus instead on creating lasting community benefits (e.g. rec centers)
- Ensure that the project provides long term benefits

Promising models

- Cameco Uranium Project in Western Australia (22 aboriginal employees in initial workforce)
- Syncrude Canada (500 FN employees, $1.2 billion spent with FN businesses)
- Mackenzie Valley Pipeline (Aboriginal Pipeline Group has right to purchase 33% interest)

BASIC OWNERSHIP THEORY

Ownership questions

1. Who owns oil and gas before it is produced?
2. Why is ownership in coal different than oil and gas?
   a. Solid versus fluid
3. What is required to perfect ownership?
   a. Texas model: nothing

b. Oklahoma: capturing
c. Pennsylvania:

4. Can you transfer/register your interest in oil and gas as an interest in land?
    a. Yes according to *Landowners Mutual*
5. Can your interest in oil and gas be defeated by your neighbor?
    a. Yes – rule of capture

Mines and Minerals

- **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 (not just where you work to obtain minerals, but the space)
- Oil and gas seem to fit into this logically
    - Contained in perforated rock
- *Cuius est solum, eius est usque ad coelum et ad infernos*
    - Traditional property ownership (to the heavens above and the hell below)
- **Common law alteration by statute (*Mines and Minerals Act*)**
- **Gold and silver *always* vest in the Crown**
    - Unless expressly transferred

Oil/Gas vs Other Minerals and Questions that Arise

- **Migratory substances in an underground reservoir**
    - Oil and gas are different from mines and minerals because they are *migratory* substances underground
    - Fluid movement – pressurized fluid that migrates from high to low pressure
    - In a reservoir (unlike coal) when you perforate it, it percolates
- **Once a reservoir is pierced and production commences oil or gas percolates through permeable rock and moves from areas of high pressure towards lower pressure producing area to equalize pressure**
    - So an oil well at one end of a reservoir will end up draining the substance that was originally on the reservoir's other end
- Question: *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?*
    - If you're the owner in fee simple, what do you transfer to a company?

Basic Ownership Theories

- Fugacious (meaning fleeting, with a tendency to disappear) substances challenge property laws
- **American approaches to the petroleum lease:**
    - **(1) Texas:** interest is separate and absolute fee simple, lease result in the purchaser holding a fee simple (caveat: the fee is "defeasible")
        - A landowner has absolute ownership over oil and gas that are under their ground
        - Where a lease is created between owner and company that wants to extract, what is created is a *separate fee simple* (oil and gas lease)
        - Absolute interest is a *defeasible fee* meaning the owner of the oil and gas is *liable to lose their fee* if someone drains it away (e.g. if it is a shared reservoir, the interest can be defeated by exploitation)
    - **(2) Pennsylvania:** ownership is something less than fee simple
        - Ownership cannot be perfected until the substance is *brought to the surface and reduced to physical possession* (essentially rendering it a chattel, personal as opposed to real property)
        - The lease interest created when the landowner contracts with a company is the creation of an *incorporeal right to explore* – a right held by the company to *explore and win* that resource but not a fee simple
            - Creates a *profit a prendre*
        - Ownership is perfected when it is reduced to possession
            - Who owns what and to what ratios is structured by the lease agreement
        - Examples:
            - If someone stole the barrels of oil stored on land it would be conversion (interference with personal property)
            - But if the oil was drawn off by other landowners in the ground this is allowed because ownership is not perfected while it is in the ground
    - **(3) Oklahoma:** exclusive explorative interest is all that can be granted, and it is separate from any interest in land (analogous to *ferae naturae*)
        - A lease can create an exclusive exploratory interest, but all you get is the right to capture something that exists in nature in a wild form

- **Canadian theory:**
    - Early cases were a conglomerate of the Texas and Pennsylvania approach
    - Generally lease agreements are characterized as a ***profit a prendre*** rather than a true lease for oil and gas exploration
        - **True lease:** pay to the landowner for the ability to do something. Stipulations exist on the lease, and if not in the same condition then have to pay
        - **Oil and gas lease**: not the same as a true lease because the land will not be the same at the end – the whole purpose is to win the resource and fundamentally change the land through extraction

English Decisions:

1. ***Borough of Bradford v Pickles*** **(1895)**
    - Bradford wanted to dig water wells and Pickles owned the land the water went under. Pickles wanted to be compensated for the use of the water flowing under his property, but no compensation for this because it is percolating water. Pickles drilled intersecting wells to stop the flow of water to Bradford.
    - Could Bradford sue Pickles for diverting the water? – no, Bradford had no legal right to the water before it entered their land. City likely paid Pickles to stop him from diverting the water
    - Is this what we want in the context of oil and gas?
        i. Maybe/maybe not
2. ***Trinidad Asphalt Co*** **(1899)**
    - Two landowners dealing with asphalt mining. Trinidad had the right to mine on one side of the property but not the other, and the resource was on both sides. Trinidad mined up to the edge and then let the asphalt ooze onto their property to collect it
    - This wasn't allowed because the *right of support:*
        i. Can't undermine the stability of property, means you can't undermine your neighbor's property causing subsistence or erosion
        ii. Company was held accountable on this basis
3. ***Burma Oil Company Ltd*** **(1929)**
    - Situation of flowing gas
    - Court said the theory was analogous to the Oklahoma theory – need possession before you have any significant interest
    - Suggests there was difficulty in finding possession for gas before it was reduced to physical possession

Early Canadian Decisions:

- ***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
    - **Lease is described as a *profit a prendre* in *Borys***
- **Ontario:** lease is a *profit a prendre* – incorporeal right to be exercised in the land described – but none of these cases mentioned the migratory nature of oil and gas, treated it as if it were a normal mineral
- **Alberta:** never defined the interest granted in a lease, no case decided directly whether or not there can be ownership of the oil and gas in place
    - ***Borys:*** the petroleum is the property of the defendants, who are entitled to do what they want with it, but also said that it can't be owned without being reduced to possession (inconsistent)
- **Saskatchewan:** petroleum in the ground may be owned and a portion of the land is sold when a lease is granted. This differs from the ordinary lease because it only grants a limited use of the land and its essential purpose is to allow the grantee to remove minerals which may be found on the land
    - ***Landowners Mutual:*** oil and gas are part of the land so they belong to the surface owner unless they are excepted from title, and he may transfer ownership just as in the case of other minerals
    - ***In re Heier Estate:*** also recognized ownership – "lease" is actually a sale of the portion of the land in the form of oil and gas
- **Present position:**
    - Most courts in Canada have adopted a theory of qualified ownership similar to Pennsylvania, but in AB there are some differences
    - In western Canada – interests in oil and gas may be conveyed as an interest in land
    - But courts haven't clearly recognized the distinction between ownership of a *right* to recover oil, and ownership of the *oil itself* in the ground

Borys v CPR & Imperial Oil Ltd (1952)

- Facts: Plaintiff 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 the term "petroleum" includes "natural gas" but when this argument failed, they claimed to be entitled to use such gas as was necessary to produce the oil
- Issue: What is included under the reservation of petroleum? Issue of waste

    - Borys says he is the owner of the gas in a cap situated on the petroleum and any gas in the solution in the petroleum under his land
    - Imperial says the reservation of petroleum includes the gas in the gas and the gas in the solution
- Reasons:
    - Need to look at the *vernacular* of the mining world, commercial world and the landowners at the time the grant was made
    - Meaning of petroleum – what was reserved was the petroleum in the earth and not the substance when it reached the surface. All the petroleum reserved is the property of the defendants who are entitled to do what they want with it
    - **A reservation necessarily implies the existence of power to recover it and of the right of working**
        - **Absence of a clause giving a right to work does not affect Imperial's position**
    - Here Imperial had a direct grant to the petroleum whereas the Appellant had only residual rights – didn't want to make Imperial under an obligation to conserve the Appellant's gas with the consequent denial of their right to recover petroleum in the usual way (doesn't make sense that neither can act without consent of the other
- Holding: *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*
    - Means that the landowner has no ownership of the oil and gas in place
    - BUT the board stated that for the purpose of its decision, it was prepared to assume that the gas whilst in situ is the property of the Appellant even though it had not been reduced to possession

***Landowners Mutual Minerals Ltd v Registrar* (1952 Sask CA)**

- *Oil and gas are minerals for the purpose of the Land Titles Act, so as long as they stay in the earth they are an interest in land and belong to the owner of the surface (unless excepted), and she can transfer ownership just as other minerals*
- *Interest in oil and gas can be registered and the title can be conveyed as a profit a prendre (right to work)*

- Facts:
    - LM wanted to transfer its interests to Keystone, they attempt to register this transfer at the land titles office
    - The Master says he can't register the title because of his perception of petroleum and gas, that they were not fixed minerals and because they were fugitive in nature he thought ownership didn't pertain to them in the same way
    - He thought all the landowner could have is a *profit a prendre*, but not a registerable interest in land
- Issue: is this an interest in land that can be transferred? (remember only interests in land can be registered)
    - If petroleum and natural gas is a mineral that it is an interest in land and can be transferred
    - *Land Titles Act* defines "land" and "transfer" but not "mineral"
- Reasons:
    - Reason advanced for holding that oil and gas are not minerals and not part of land capable of being transferred:
        - They are "fugitive and vagrant in their habits" and the surface owner can't be said to have absolute property in them until he has mined them and reduced them to his actual possession and control
        - This argument by the Master was aligned with the Oklahoma theory that oil and gas is similar to wild animals – not owned until reduced to possession
- Analysis:
    - Overall: No statute existed that narrowed the definition of "mineral" – it is broadly defined
        - 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 can transfer ownership just as other minerals
    - Also looked to: (1) statutes/related statutes (2) case law/analogous case law (3) vernacular meaning (4) lexicon used by the individuals in the area
- **Key takeaways:**
    - Oil and 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)
    - Ownership can be registered and conveyed (transferred) just like any other mineral
    - There is a limit on fractional transfers – under the *LTA* you cannot divide the mineral estate smaller than $1/20^{th}$
    - Be clear in drafting – court here removes reference to "related hydrocarbons"

- Importance: this was around the time of the ALR article, people struggling to understand ownership in land. It allows us to think about these sorts of aspects as being something that can be traded, sold, and worked upon

What Our Current Statutes Say

Land Titles Act

- *Under s 1(m): description of land*
    - "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 timer thereon, and mines, minerals and quarries thereon or thereunder lying or being unless any of them are specifically excepted
        - Mines and minerals constitute part of the land
- *Sec 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

- *Sec 79: 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 certain term 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, or or under which that mineral is situated
        - "Lease" in LTA includes a mineral lease – beyond a true lease seen in a rentor, lessee, lessor relationship
        - Need to look at the specific statutory instrument in question

Mines and Minerals Act

- *Sec 1(1)(p): definition of minerals*
    - Includes petroleum, oil, asphalt, bituminous sands, oil sands, natural gas, and coal
    - Does not include sand and gravel, clay and marl, and peat (all belong to the surface owner)
- *Sec 10.1(1): coalbed methane*
    - Coalbed methane is defined to be and to have always been natural gas
- *Sec 15.1: pore space*
    - Pore space is the property of the Crown
    - Important for carbon sequestration

Persistent Problem

- **The existence of a registerable interest does not allow you to exert exclusive possession until the substance is obtained at the surface**
    - Means you can drain a reservoir that extends under/into a region "owned" by your neighbor
- **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
    - But if a reservoir is tapped from many locations the natural pressure is lost, and it is non-economical to extract the entirety of the reserve
    - Artificial pressure must be applied, making the extraction more expensive
    - Overall: leads to premature collapse and inefficient return on the resource
- Examples:
    - LA's Urban Oil Forest (1895)
    - Spindle Top Texas (1902)

Alberta's Regulatory Response

- AB responded to the possibility of inefficient development through a comprehensive regulatory approach

- ***Oil and Gas Conservation Act*** **(and associated *Oil and Gas Conservation Rules*)**
    - *Section 4: purposes*
        - To effect the **conservation of,** and to prevent the **waste of,** the o/g resource of AB

- Conservation = orderly development, extract as much as possible in an efficient way (avoid spindle top/artificial collapse)
- Prevent the waste of oil and gas in AB (leaving oil and gas obtainable for the future)

▪ 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 allows the province to tell a property owner where to drill a well
- Want safe and orderly practices

▪ To provide for the **economic, orderly, and efficiently development** in the **public interest** of the o/g resources of AB
- Public interest = safe practices/use, *maximizing return* from the resource

▪ 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 his piece of the pie (target areas also achieve this)

▪ To provide for the recording and timely and useful dissemination of information regarding o/g resources in AB

▪ 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

o *Achieving purposes*

▪ <u>Licenses (ss 11, 12, 15,16)</u>
- Cannot drill or pursue related activities without a license (s 11)
- Cannot operate unless government approval has been obtained (s 12)
- Need to apply to the AER (regulator) for a license (s 15)
- Cannot apply for a license unless the person is a working interest participant entitled to the right to produce the oil or gas (s 16)

▪ <u>Restrictions (ss 34, 26)</u>
- These sections allow the government to restrict the amount of oil and gas being produced from a pool or reservoir at any time based on the conditions at play
- Can restrict based on the market demand (s 34)
- Can restrict gas production so the natural pressure is not prematurely depleted (AER limits production of gas because gas is often something that you want to produce after oil has been produced) (s 36)

▪ <u>Waste prevention (s 38)</u>
- Board can allow and require enhanced recovery operations, e.g. that uses artificial lift/pressure to recover substances
- Gives regulator broad scope to prevent waste

▪ <u>Scheme approvals (s 39)</u>
- Lists schemes that can be approved to ensure efficient development
- If there are variations sought, have to make an application to the regulator for justification for carrying from standard practices

<u>How OGCA Achieves its Purposes</u>

- **(1) Drilling Spacing Unit (DSU)**
  - The minimum area allocated for the purposes of drilling a well
    - Purpose: to allow for efficient recovery of oil (prevent spindletop)
  - ***Sections 4.010(1) and 4.021(1) of the Oil and Gas Conservation Rules (OGCR)***
    - 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 area
      - (2) Does not include the area of road allowance
      - (3) Unless the Regulator otherwise prescribes under s 4.040, the surface area of a DSU for
        - (a) <u>an oil well is ¼ section (4 legal subdivisions)</u>
        - (b) <u>a gas well is 1 section (16 legal subdivisions)</u>
    - Section 4.021
      - (1) Unless the Regulator otherwise prescribed under s 4.040, in a DSU
        - (a) <u>2 gas wells may be produced from each gas pool with the exception of</u>

                - (i) coalbed methane
                - (ii) the area in the map set out in Schedule 13A
                - (iii) the area in the map set out in Schedule 13B
            - (b) one oil well may be produced from each oil pool in a DSU except for the area in the map set out in Schedule 13A where two wells may be produced
        - (2) No well shall be produced unless there is common ownership throughout the DSU
    - **Original presumptive rule:** one gas well/section; one oil well/1/4 section
        - This is largely a myth because of new density drilling rules
        - On a map it is clear this presumptive rule has been set aside many times
        - Areas of the province have been designated as allowing for different activities
            - E.g. no limit for coal bed methane
    - **Tight gas excluded; large swaths for gas production have had the DSU altered (Mannville Group/Smoky Group)**
        - Drilling for tight gas requires precise long vertical wells as the gas is usually found in narrow, cylindrical formations
    - **Section 15(3) of *OGCA* and section 4.021(2) of *OGCR***
        - There must be **common ownership** throughout the DSU before you can have a license to begin drilling
        - BUT this is not very common – a lot of areas with productive resources have been subdivided and ownership is not common
    - **Special drilling-spacing units (s 4.040(1))**
        - The Regulator may prescribe the surface area or target area of a DSU to be produced in a DSU if the applicant shows that:
            - (a) Improved recovery will be obtained
            - (b) Additional wells are necessary to provide capacity at a reasonable rate that will not adversely affect the recovery from the pool
            - (c) The DSU would be in a pool in a substantial part of which where are existing DSUs that allow the same number of wells that may be produced
        - Onus here is on the applicant, technical criteria

- **(2) Target area**
    - A target area marks where, within a DSU, the well must "bottom out"
        - One key feature of a DSU is where the well bottoms out, meaning *where does the well actually perforate the reservoir*
        - The target area refers to the location where the well perforates the resource in the ground (not interested in where the surface structure is, but where the actual perforation is happening)
        - Purpose: maintains approximately equal spacing between wells, prevents clustering of wells
            - Promotes (1) equitable withdrawals and (2) reduces drainage across lease lines
    - Prior to 1981 the well had to bottom out at the center of the quarter section for oil and in the interior 4 legal subdivisions for gas divisions
    - **Target areas since 2011: s 4.040 of *OGCR***
        - Oil wells: must bottom out at least 100 m from all boundaries of the DSU
        - Gas wells: must bottom out at least 150 m from all boundaries of the DSU
        - Penalty for missing – 4.060
            - Ability for Regulator to prescribe a penalty for missing target area
    - Essentially regulating where reservoirs are being perforated

- **(3) Pooling**
    - Pooling is the **response to the problem of needing ownership rights for the entire DSU to get the license** (s 4.021(2))
        - Remember: need common ownership throughout DSU to make an application for drilling
    - Definition = combining tracts of land to form a DSU
    - Can be *voluntary* or *compulsory* (ss 80-84 *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 owners of a tract within the DSU may apply to the 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
            - Requires application for an order allowing all the tracts of land to operate as a single unit

- Need to prove:
    - (1) Evidence the agreement couldn't be struck between the owners on reasonable terms; and
    - (2) Evidence on what the proportionate distributions should be between owners (default is an area-based percentage)
- Essentially you have to make a reasonable offer for land development, and if the offer is reasonable and rejected, can apply for a pooling order which pools the land for the purpose of development, and will allocate the production based on the physical characteristics of each tract of land in the area
    - Purpose: to prevent one owner from frustrating the other owner from moving forward with the DSU
- **Allocation of production to each tract on the basis of area (i.e. percentage of the pool)**

- **(4) Unitization**
    - Response to the situation where there are multiple DSUs in close proximity to one another draining from the same pool
    - *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 is 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, see s 79(1) *OGCA*)
    - Usual practice is that unitization can be achieved – overall tries to further build in efficiency by looking at a reservoir more broadly, seeks the most efficient results
    - Example: *Prism Petroleum*

Indirect Monopolization and Fair Access

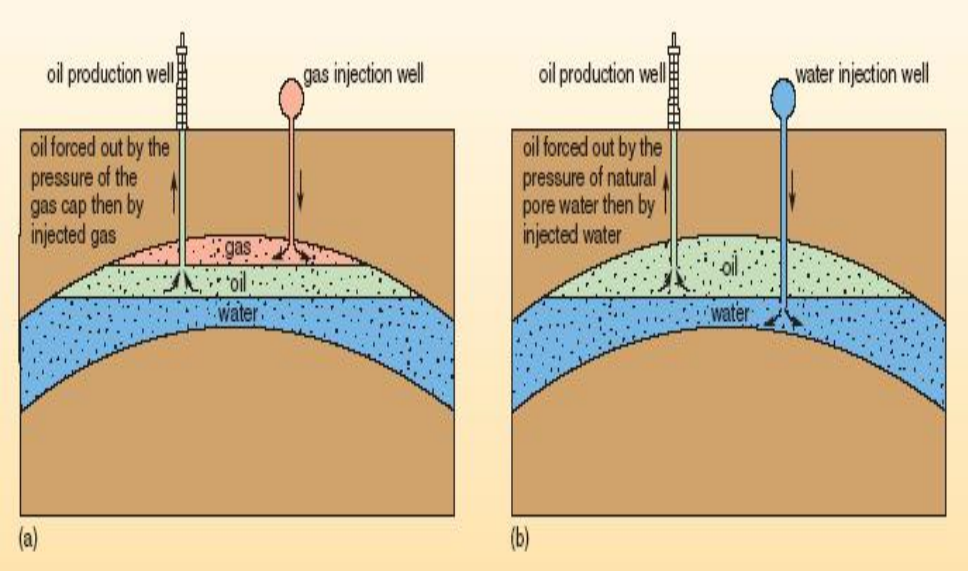
- **Example:** A company has a direct link from its well to an oil refinery. They are capable of producing at a faster rate than smaller producers who have adjacent leases. It is true that everyone can drill a well, but it is not true that everyone can get their share of the common pool
    - May also have certain transporting companies that only service certain oil extraction companies, giving an advantage to those producers and not others
    - How can small player participate when they don't have access?
- **Solution:** Access to transportation (common carrier orders), refining facilities (common purchaser orders) and processing facilities (common processor orders) resolve the problem of indirect monopolization

- **(1) Common carrier orders (pipeline capacity/access) – ss 48 & 49 *OGCA***
    - **Rule:** Service cannot be denied 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
        - 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**
        - Cannot:
            - Prioritize own interest (s 48(3))
            - Discriminate against someone who transports oil through their pipeline
            - Discriminate with their own product at the expense of others who wish to use the pipeline
            - Discriminate in price or capacity
- **(2) Common purchaser orders (equal market access/purchaser access) – ss 50-52 *OGCA***
    - Concern: can be indirect monopolization driven by large producers trying to overwhelm the market
    - Applies to any party who purchases, produces, or otherwise acquires oil produced from any pool in AB (refinery)
        - Allows purchasers to get equal access to the market guaranteed by a legal order in ss 50-52
    - An application can be made to declare a party as a common purchaser
        - Means a refinery can be deemed a common purchaser, so they must purchase all oil (or gas) offered for sale to it without any discrimination (s 50 and 51)
    - Exception: only ability of a common purchaser to deny purchase is on the basis of inferior or different quality/composition (s 52)
- **(3) Common processor orders (processing/refining capacity) – ss 53 & 54 *OGCA***
    - Common for there to be initial processing of gas fairly quickly after extracted, allows the hydrocarbons to be separated by molecular weight

- 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)
- Exception: only relief afforded to a common purchaser is on the basis of inferior or different quality/composition (s 54)

- NOTE: all of these orders are subject to the existence of **capacity**

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 downwards pressure
- **Oil reservoir**
  - In situ this layer is in liquid phase
- **Mixed reservoir (solution gas and evolved gas)**
  - **Solution gas/associated gas:** there will be a certain amount of gas in the liquid oil in situ; but when it is recovered/brought 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 (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 and salty – has minerals from sedimentation in it
  - There is also gas dissolved here too (unresolved in terms of ownership)
  - May be in the pore space in the rock or in its own aquifer basin
  - Note: *water belongs to the Crown*
- Problem: challenging to have to consider what phase the substance is in at different times of exploration, and what happens if you split title so there is a gas owner and an oil owner
  - Who owns the gas dissolved in oil and liquid in the ground, but that emerges as a gas?

***Borys v Imperial Oil* (1953 UKHL)**

- *Petroleum meaning by vernacular test; does not include NG; implied right to work and produce the product despite wasting other substance*
- *First major AB-based question that changed how we decide ownership problems*

- Facts:
  - Borys acquired land in fee simple that had the following reservation on the title: "all coal, petroleum and valuable stone"
    - 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 land
  - Problem complicated because above the petroleum is a layer of NG which Borys claims is his
    - Borys believes the NG was not included in the term "petroleum" found in the reservation so he was entitled to it

        - Once the NG is removed it will be mixed with petroleum (pressure change causes some NG to turn from liquid to vapor form)
- Issue: who owns the NG beneath Borys' land?
- Reasons:
    - **Vernacular approach:**
        - Court determined that **petroleum**, with a non-scientific interpretation (**vernacular approach**) 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 on the *vernacular of the mining world, the commercial world and the landowners at the time the grant was made*
        - Natural gas was a vapour and NOT included in the definition of petroleum
            - But when the NG was dissolved in solution, it would be included within the definition of petroleum and belong to the petroleum owner
    - 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, was not found – interest was a profit a prendre
        - Imperial couldn't stop Borys from extracting gas (even though it would harm Imperial because necessary for oil extraction)
            - Can "**hold the reservoir hostage"** so Borys has the *leverage to extract a beneficial arrangement*
    - **Permitted waste**
        - Imperial has a direct grant to the petroleum and are not under an obligation to conserve Borys' natural gas
            - A reservation of the mines and minerals (or petroleum) is **meaningless unless it is accompanied by the right to work and recover the substance reserved**
        - 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 make the determination of ownership concerning the phase:**
        - Look at the ***time of the reservation –*** *initial reservoir conditions*
- Holding:
    - The gas whilst in situ is the property of Borys even though it has not been reduced to possession
    - Borys can recover the NG by any usual and customary manner but cannot prevent Imperial from following a similar course
- **Key takeaways:**
    - Petroleum owner is entitled to the *liquid* hydrocarbons in the pool/reservoir
    - Phase-based ownership determination is to be made in the ground
    - Ownership determination at the time of contracting
    - Petroleum reservation includes an implied right to work and produce the product
    - Vernacular (not scientific) interpretation to govern
- **Importance:**
    - Lasting and important precedent
    - Unexpected because the court was giving an opinion on a very specific question early on in o/g jurisprudence, but it carries through to subsequent decisions
    - Court didn't look to connate water, dissolved gas, etc. – instead this decision has often been applied by analogy

<u>Problems with the Typical Reservoir</u>

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

SURFACE ACCESS

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"
- Assumptions we make about the property we own: (Kaplinsky & Percy)
    - "that we will be able to use it and enjoy it, develop it as we desire, exclude other 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 CL with severance of mineral title from surface title (now changed by Surface Rights Act)

- At CL when the title to the minerals was severed from the title to the surface a right of entry arose at law by necessary implication
    - Rationale: unless the owner of the minerals was to enjoy a right to enter the surface to work the minerals, there would be no severance
    - Basically no one would take title to the minerals unless they could be worked
    - So the mineral owner was allowed to disturb the surface owner's right to use the surface *to the extent reasonably necessary to work the minerals*
    - Limits: (1) to the amount of damage and disturbance (2) mineral owner not entitled to cause subsidence of land or deny the surface owner's right to support
- Legislature **altered the right of entry** that existed at CL: (*Surface Rights Act*)
    - Operator is now **required to pay the landowner for the right of entry and user as if the right were taken from the landowner**
    - This is just as much a taking as someone who installs power lines, pipelines, etc.

Surface Rights Act **– right of entry**

- ***Section 12(1)****:* getting access to the surface involves getting consent of the owner and lessee, and in the absence of consent you must look for an order from the board
    - "No operator has a right of entry with respect to the surface of any land… unless the operator has obtained 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 is refused (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
    - NOTE: never says you can have access for mine and mineral *exploitation* (which is odd because this right exists at CL)
- ***Section 12(2):*** separate sum for access
    - Operator must provide compensation separate from the price they paid for the mineral or petroleum rights to be able to receive surface access to work the land and extract the resource
- **Orders –** ***ss 15 and 16***
    - **Section 15:** process to make an application
        - (1) When the operator cannot acquire the consent of the owner and the occupant, they can apply to the Board for a right of entry order
        - (2) Board will look at the reasonableness of the offer and see why an agreement couldn't have been reached before an application was made
            - Need to see a copy of the most recent written offer and satisfactory evidence that the offer was refused
        - (6) The Board can make an order (see *Encana Corp*)
            - Can describe the portion of the surface of the land necessary for operations, and make any other order it considers appropriate
    - **Section 16:** actual order the Board can make
        - Gives the operator the right to enter
- **Compensation provisions –** ***ss 19, 23-25***
    - **Section 19:** the first form of compensation for the owner will be an entry sum
        - Entry fee is the amount of money that is the lesser of $5000 or $500/acre
    - **Sections 23-25:** board can craft a compensation scheme

        - Board only grants a right of entry in exchange for compensation
        - Compensation is determined based on the market value of the land and other factors like the price per acre, loss of use, adverse effect of the area, damage to the land, etc.
        - Board may consider the lost value in making a compensation order – e.g. damage caused by operations, damage to livestock, etc.

***Encana Corp v Campbell* (2008 ABQB)**
SRB can grant right of entry subject to conditions as long as the conditions are not inconsistent with the license granted to the licensee (s 15(6) SRA))

- 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
- Sec 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 AER license takes priority
- Statutory intervention is there to **relieve the harshness of the CL;** the scheme rights the wrong allowing negotiations to occur, intervening if they don't, and compensating the surface owner for a disruption that is happening
    - What might be perceived as a statutory taking **should actually be perceived as improving a shortfall under the CL** which gave that natural easement to the operator without compensation to the surface owner

SOLUTION AND EVOLVED GAS

***Prism Petroleum v Omega Hydrocarbons* (1994 ABCA) – solution gas**
Ownership of liquid oil vs <u>solution gas</u> (solution gas part of petroleum); point in time and location of ownership definition; followed Borys

- Background:
    - Prism entered into a unitization agreement for the West Provost Viking Gas Unit
    - Omega has two operating oil units in the boundaries of the gas unit
    - 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 <u>recovered in liquid form</u> from the unitized zone through a well by ordinary crude oil production methods (owned by Omega)
            - If recovered as vapour, belongs to gas owner (Prism)
        - Note: unitization is a unit agreement 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 (means the initial 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 an order declaring their ownership of the solution gas, and damages for wrongful conversion
- Issue:
    - Does recovery happen at the bottom of the wellbore or at the surface where the substance emerges?
    - Is Omega violating anyone's rights by producing gas along with its oil?
- Reasons:
    - The gas at the heart of this dispute is **solution gas** (emerges at the wellhead as vapour but is in liquid form in the reservoir)
        - Issue is reduced to whether the plain words of the definition related to surface or reservoir conditions and whether the ownership of resources will be strictly determined based on the time of conveyance and the state of the resources while in the reservoir
    - Once the case is characterized as a solution gas case, it seems appealing to apply *Borys* and hold that Omega as the petroleum owner can take the solution (because the gas was in the 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*
        - *Borys* also looked at a reservation, vs this is a unitization agreement
        - *Borys* agreement defines petroleum substances in a different way than this agreement

- The court still followed *Borys* and said that because there is not a test for determining the nature of ownership of a substance at the surface, we must **look at the reservoir conditions**
    - So the solution gas belongs to Omega
- Holding: Solution gas belonged to Omega because it was in liquid state in the reservoir (court followed *Borys*)
- **Key takeaways:**
    - Solution gas is part of petroleum recovered from the well (belongs to oil producer)
    - "Point of recovery" focuses on reservoir conditions as opposed to surface conditions
    - Application of plain words to discover meaning
    - Recovery occurs at the bottom of a well-bore hole

Anderson v Amoco Canada Oil and Gas **(2004 SCC) – evolved gas**

Evolved gas; hydrocarbon entitlement determined by phase at the time of transaction, meaning initial reservoir conditions

- Background:
    - In 1904 the CPR recognized the inherent underground value of the land they owned. 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 mines and minerals. 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**
    - This appeal is about the contracts entered into between 1907 and 1912 – reservation of "petroleum"
- Facts:
    - Appellants were owners of NG and argued that ownership of NG should be determined at the time the hydrocarbons entered the bottom of the wellhead
        - Appellants tried to show there was a developed theory of OG ownership – that evolved gas belongs to gas owners since "Canada is not an in situ ownership jurisdiction"
    - Petroleum owners 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
- Issue:
    - What is included in a reservation of oil, and at what point should the determination be made?
    - Basically – did the *Borys* decision pertain to original reservoir conditions or the conditions of the hydrocarbons arriving at the wellhead?
- Reasons:
    - **Result:**
        - 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
        - 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 discovery
    - **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 decreases), creating evolved gas (gas previously held in liquid becomes gaseous)
            - There is also 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 the **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 non-petroleum owner are entitled to
        - This is practical because ownership would be under constant change as pressure constantly decreases – it is relatively easy to determine the oil to gas ratio at time of transaction using expert reports
        - This adhered to the logic in *Borys* that we must look to the vernacular (layman's definition) at the time of the grant
        - They chose to divide their interests by contracts – can't later argue that the division was meaningless on the basis that no rights can attach until the substance is reduced to possession
    - ***Borys*** is essentially being evolved into 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 two previous cases. If the court in *Prism* intended to treat evolved gas differently than solution gas, they would have done so
        - **Ownership theory is skirted**
            - It would not make 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 comes steam

- **Connate gas:** gas that emerges with connate water does *not* belong to the petroleum owner
  - Since under the *Water Act* all water in AB belongs to the Crown this implies that they own the gas contained in the water at the initial phase
- Holding: reservation of petroleum includes all hydrocarbons which were in liquid phase in the ground at the time of the transaction (when the lease was signed, or at original pool conditions, NOT at the bottom of the wellbore)
- **Importance:**
  - Brings the historical *Borys* decision into the world of evolved gas and settled the final outstanding dispute
  - Petroleum owner gets evolved gas

Ownership of Split Title Lands – Summary

(1) **Petroleum owners:** entitled to all hydrocarbons that 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

(2) **Non-petroleum owners:** entitled to all hydrocarbons which were in gas phase in the ground at the time of the transaction (grant/lease), regardless of the phase they are in upon recovery
  - May be excluded from owning petroleum on the title by, e.g., leases that gave rights or reservations on title

(3) **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
    i. If this rule applied only until the point when the phase change occurs, all ownership based on phase could be defeated – the party who reduced the substance to possession by drilling the well and producing the hydrocarbons would be entitled to all of them, and the other party would have no claim
    ii. If parties had already agreed to divide their interest under a contract, this would defeat the purpose of the contract
  - Oil does not have to be reduced to possession to become the subject of ownership
    i. This is clear from *Borys* and *Anderson* which declared that ownership exists before the reservoir is penetrated
    ii. Can be changed through contract
  - Ownership is perfected by capture at the surface, but rights holders have exclusive right to work the land for the resource

(4) **Connate gas:**
  - Raised by the *Anderson* case and suggests issues
  - Government of AB likely owns the connate because it owns water under the *Water Act*
  - BUT largely left unresolved at this point

(5) **Overall:**
  - *Borys* has been frequently reapplied despite its limited intent for future application
  - Favour vernacular approach over technical as the approach to interpretation going forwards
  - Focus on stability and certainty

GAS OVER BITUMEN

***Alberta Energy Co v Goodwell Petroleum Corp* (2003 ABCA)**

Bitumen owner has the right to incidentally produce NG in bitumen recovery using ordinary reasonable production methods; subject to the rights of NG owners for compensation

- 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 shut in – this is what occurred in this case
- Facts:
  - Goodwell held the petroleum and natural gas rights on five continuous sections in the Athabasca oil sands; AEC held the bitumen rights
  - AEC was producing the bitumen and Goodwell alleged AEC was using its NG, which it did not have a right to do in its extraction of bitumen
  - Goodwell alleged that AEC's production had a high gas to oil ratio (how much gas is being produced from the 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 rights holders until AEC has the "full rights to produce"
    - Main issues: (1) no right to produce the gas cap held by the bitumen owner and (2) conservation issue because of high gas to oil ratio, may have a negative impact on the overall recovery of bitumen in that area
- Issue:
    - To what extent can EUB shut in the 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?
- Reasons:
    - EUB objected on the following grounds that were <u>not</u> 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 the application of the *Borys* principles
            - 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 pressure assists in moving the bitumen and is therefore critical to recovery, and some initial gas cap gas is inevitably produced with their bitumen
            - **Implied right to recover by reasonable means:** this is about two parties asserting their rights, each 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; so the bitumen owner only has a right to bitumen and not NG
            - Court disagreed
                - If this were upheld we would have a holdout problem with the NG owner because the bitumen owner would need the NG owner's permission to produce
                - M&A Act does not take away CL 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 disagreed – *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 Goodwell gas lease was irrelevant**
            - Argument: since the NG 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 gas the gas cap gas was a reasonable and expected consequence of this recovery, the date the lease was granted was irrelevant
    - **Common law principles:** note – remember *Borys* (implied right to recover)
        - (1) A right to bitumen includes the right to do all things reasonably necessary to recover bitumen
        - (2) If mining and recovering minerals results in a known and inevitable consequence, that consequence is construed to be an implied term and the holders of lands or other minerals affected by that consequence can't enjoin mining and recovery of the minerals
        - (3) These principles apply to reservations, grants, and leases (including Crown leases), otherwise the mineral right would be useless
        - (4) While a bare right to a mineral conveys a right to work, win and carry away the mineral, that power can be expanded or restricted by express wording in the deed
        - (5) Relevant statutes may modify these principles
    - **Public policy reasons:**
        - Oil sands lessees would not be inclined to expend vast amounts on exploration and development is the discovery of a gas cap would restrict their recovery rights and devalue their investment
        - Retroactively changing the economics may compromise financial security, undermine investor confidence and potentially impair the exploration of these resources
            - In interpreting terms we should try and avoid and interpretation that diminishes the value of the other lessee's interest

        - Only main prohibition against operations that completely destroys the surface of the land
- Holding:
    - AEC's express right to work, win, recover and remove bitumen under its oil sands leases entitles it to produce initial gas cap gas incidental to bitumen recovery using ordinary methods of production, **subject to rights Goodwell may have for compensation for the initial gas cap gas produced (but details of compensation not addressed)**
    - Board did not have jurisdiction to shut in the wells
    - Court sees this dispute as being under the purview of *Borys*

NOTE: *Oil Sands Conservation Act* is broadly analogous to *OGCA* purposes

***Gulf Canada Resources Ltd Request for Shut in, Surmount Area* (2000, EUB)**
Gas wells shut in due to significant risk and not in the <u>public interest</u>

- Facts:
    - Gulf had a bitumen lease from the province, and the province lease 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 objected, argued that SAGD technology was too uncertain and that shut in is an overreaction
    - EUB shut in 146/183 gas wells
- Argument (Surmont)
    - Potential for resource sterilization is not in the public interest (s 99 *OGCA*)
    - It is not worth shutting in to protect a resource that has no current economic value
    - There were many other bitumen areas not subject to shut in
    - The current market value of NG would be $190M and the cost of a shut in would be $11M to the wells
- EUB reasons:
    - The potential of resource sterilization is a <u>matter of public interest</u>, which is part of its mandate
    - Recoverable bitumen reserves were roughly between 5.25 and 7.5 *billion* barrels, whereas NG reserves were 17-32 million barrels; in the province's best interest to preserve bitumen
        - The amount of bitumen at stake was substantial
        - The board was concerned that the bitumen resource would be sterilized by production of the NG
    - It could take 200 years to produce the bitumen, but it is not reasonable to force bitumen development by requiring leaseholders to demonstrate commitments to projects within a given timeframe; this would *discourage investment in bitumen projects*
        - Not reasonable and prudent to force development – cause ill-timed investments
        - Could imply that public interest is driven by specific operator's plans for bitumen projects
        - Board's conservation role must consider a broader set of issues that the immediate plans of one company or industry sector
    - EUB was unwilling to rely on re-pressurizing depleted gas zones by gas injection – feasibility hadn't been demonstrated (same for re-pressurizing with water)
    - Metis views: Gulf bitumen developers had been more responsive and willing to hear Metis views and concerns than NG developers
- Compensation issue
    - The shutting in of the resource looks like expropriation
        - But the expropriation is temporary, not permanent – deferral of the right to develop the gas resource

***Authorization of an Agreement Between the Crown and Conoco Canada Resources Ltd et al* (OC 83/2002)**
Gas rights holders were paid compensation for deferred production; will pay gross overriding royalty when eventually producing gas

- Conflict:
    - Gulf benefitted hugely from the EUB decision to shut in the production of gas wells
    - NOTE: what we have is *deferred* production of gas – government will pay you a sum of money, but when the gas owners produce the 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
- Agreement: (between Crown, oil sands holder and NG holders)
    - Terms:
        - Para 5: Crown must pay $85 million to the owners of 146 gas wells
            - Paid through royalty rebates or waivers on royalties on gas from other producing wells
        - Para 7: GOR is a percentage over the normal royalty rate (here it was 11%)
            - Applies to any production from the shut-in wells once production is permitted
        - Para 12: Gulf's slice of the $85 million is $20 million

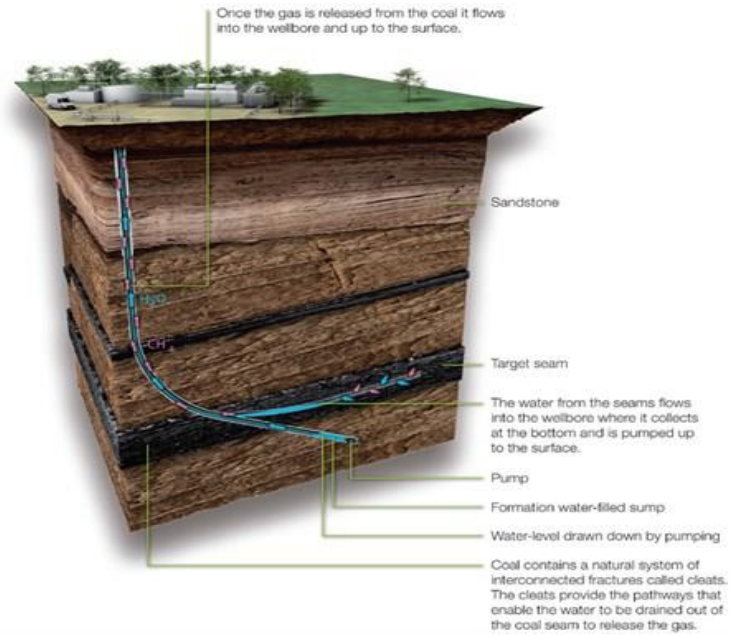
        - In 2026 they start paying it back, or when the revenue from the Surmont project exceeds sunk costs
    - **Government compensates gas lease holders for the shut in, Gulf agrees to partial reimbursement of government losses**
    - Large amount of money that gas holders are forfeiting in the short term, so the government waives royalties on other wells (allows them to produce at a higher rate on these others)
    - To be paid back the government takes a **gross overriding royalty** – carved out of the proceeds of a well, a cost-free share to the production that is paid first
    - Overall: method to ease financial loss in the short term and recoup the benefits moving forward
- Importance:
    - Example of how parties came together in an equitable result to make an agreement in the public interest
    - Oil sands recovery was maximized to the detriment of the gas holder, but worked out a creative payment structure between the three parties to allow expenditures to be accounted for

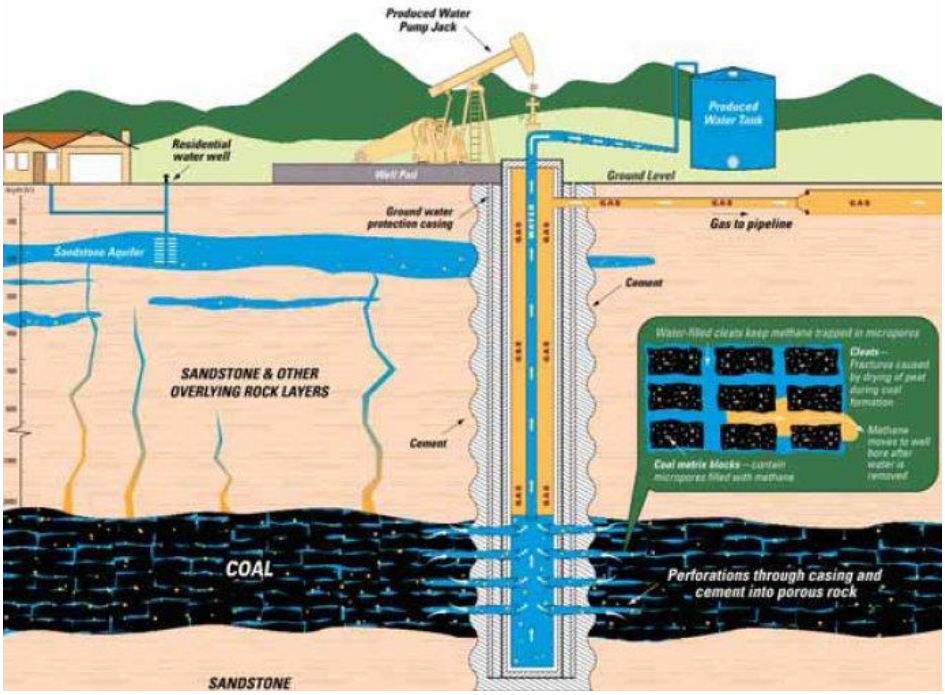
COALBED METHANE

Overview

- **What is it?**
    - Methane that is trapped in a coalbed
    - A form of tight gas – unconventional form of natural gas formed during the production of a coal bed
    - **Composition:** CBM is similar in composition to gas cap gas and exists in three states:
        - (1) Free gas within the porous material;
        - (2) Dissolved in water in the coal;
        - (3) Gas absorbed on the solid surface of the of the coal (coal pores have a larger surface than other rock so more gas exists in this state in coal
- **How is it formed?**
    - Formed under specific circumstances (high pressure)
    - During the production of coal some hydrocarbons are transformed and escape as a gaseous form and get stuck within the coal
    - Formed through gasification through the creation of coal
- **How much CBM is in AB?**
    - Coal seams with CBM potential are found underneath much of AB, especially in the south and central areas
    - AB Geological Survey estimated there could be as much as 14 trillion cubic metres of CBM in AB coal (for comparison, about 5.7-7.1 trillion cubic metres of marketable conventional NG in AB)
    - Potential size of CBM suggests that it will make a significant contribution to Canada's energy security in the future
        - In 2006 about 1,723 wells in AB
    - Value of coal in AB is not very high
        - Need to burn a lot of it to get the heat needed
- **Why is it unconventional?**
    - Because a reservoir depressurization step is needed during development to release the gas from the coal and make it flow to a well
    - This can be accomplished by allowing free gas within the naturally occurring cracks and fractures in the coal to flow to the surface, or by pumping out any natural fluids occupying the connected cracks and fractures
        - 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 by the Alberta Energy and Utilities Board
    - All existing regulations apply to CBM in AB - CBM operations not covered by existing gas regulations are handled by special applications
    - ERCB Directive 056 directs that all CBM wells, pipelines and facilities licenses receive a special code for tracking purposes, and any requests for commingling and for produced water disposal are governed by this directive
    - All produced water from CBM wells in AB require disposal by deep well injection

- Coal seam has 3 forms of methane
- Injection well to fracture coal
    - Give pathways
- Return used substances to the surface
- Use wells for extraction





- When you fracture CBM or shale and are removing the used liquid, the fissures still need to be kept open
- Requires a **proppant** to be injected to keep 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:
    - Land patents were issued to western settlers pursuant to the Coal Lands Acts of 1909 and 1910 which conveyed the land and everything in it except the "coal", which was reserved to the US. Patented lands included reservation lands previously ceded by the Southern Ute Tribe to the US. These lands contained large quantities of CBM gas – at the time of the Acts it was considered only a dangerous waste product, but is now a valuable energy source
    - O/g companies entered into CBM leases with the individual landowners of 200,000 acres of patented land in which the Tribe owns the coal – they filed suit seeking a declaration that the CBM gas is coal reserved by the Acts
- Issue: Do the owners of the coal (from the land patents under the Act) also own CBM?

- Reasons:
    - **Test:** to determine whether CBM is part of the coal reservation, the question is: *at the time of the grant/reservation, 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), idea of what was the major energy source in America at the time
    - Concluded that **coal does not include coal bed methane as contemplated** because:
        - (1) Gas is not a solid – coal bed methane escapes from coal, and when the grant was made it was not mind
            - **Distinguishable** as resources: gas is not solid, CBM escapes from coal and is not mined
        - (2) The interest reserved was to reserve to the government "energy fuel"
        - (3) Congress wasn't concerned with the right to produce the CBM – at the time it was perceived as waste
    - **The right to dissipate the CBM gas where reasonable and necessary to mine the coal does not imply *ownership* of the gas in the first instance**
        - Only reflects the CL right of the owner of one mineral to use a neighboring estate
- Holding: CBM belongs to the surface/gas owner, NOT the coal owner
- Dissent (Ginsburg J)
    - Took the view that ownership should follow responsibility and that Congress would not likely have intended a change in ownership because a liability became an asset
        - Not equitable to "flip the script" and change ownership now that the liability is a benefit
    - Would have applied the canon that ambiguities in land grants are construed in favour of the sovereign

***Re Bearspaw Petroleum Ltd* (2007, AEUB)**
Coal reservations do not include rights to CBM; ability to mine CBM falls to the NG holder

- Facts:
    - Encana, the owner of the coal rights, argued that the well licenses for production of CBM by the gas rights owner (Bearspaw) should not be granted because Encana, as the coal owner, was entitled to CBM
- Issue: was the mineral owner of gas or coal rights entitled to the CBM?
- Reasons:
    - What was AEUB's role here?
        - Giving an opinion to the parties (but not necessarily determinative)
        - AEUB is not a court, but is trying to quiet title in this instance
    - Board determined that according to the *Borys* principle, the plain meaning of coal understood in the early 1900s was a solid substance (similar to rationale in *Southern Ute*)
        - The **vernacular meaning of coal at the time did not include the presence of CBM**
        - Vernacular meaning throughout history was consistent in distinguishing coal as a solid substance separate from CBM
        - **Right to dissipate CBM gas where reasonable and necessary to mine the coal does not imply ownership of the gas** (cites *Ute*)
    - Board accepted that the proper principles to apply in considering entitlement or ownership are set out in *Borys*, *Anderson* and *Goodwell*
        - *Goodwell: ABCA* acknowledged that to make a legal determination of the right to extract resources, the Board must determine the relevant leases, energy statutes and applicable case law
        - *Borys* and *Anderson:* in ascertaining the intention of parties to the relevant grants, reservations or exceptions, the words in the instruments must be interpreted in the ordinary or vernacular, not the scientific sense, as used by landowners, businesspeople etc.
- Holding: Board found that the "coal" in the instruments does not include CBM, so Encana does not own and is not entitled to the CBM; the issuance of well licenses for CBM separate from the coal reservations was justified

Legislated Clarification

Mines and Minerals (CBM) Amendment Act, 2010

- Addition of section 10.1:
    - (1) **Coalbed methane is hereby declared to be and at all times to have been natural gas**
    - (3) The owner of the title to NG in any land, and any person holding NG 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

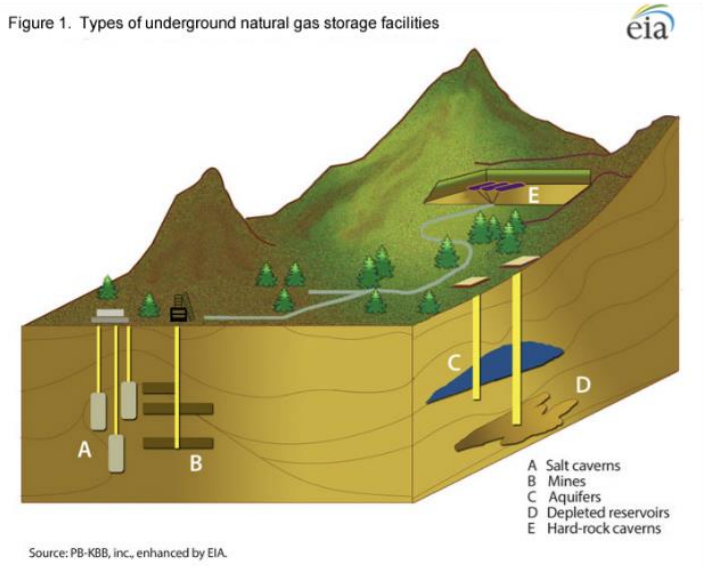
damages or compensation because of extraction, production or removal of CBM from the land if that extraction, production or removal occurred before the coming into force of this section
        - Basically: codification of the CL rule that the owner of the coal can extract the coal by ordinary and reasonable means, and will not be held liable for the damages to the associated CBM that may arise in the process
        - Retroactive declaration to deal with future disputes, but no retroactive compensation for CBM previously exploited or released
    - (4) For the purposes of the *Expropriation Act* **no expropriation occurs** as a result of the enactment of this section
- Section 67: makes clear that the lessee of coal owned by the Crown has no rights to any natural gas, including coalbed methane
- Overall:
    - Natural gas owner gets CBM (*unless* previously disposed of; no actionable wrong for prior interference with CBM)

Coalbed Gas Act, 2003

- Coalbed gas must be considered to be and to have always been natural gas

STORED GAS

Overview



- Can store gas in:
    - (1) Salt caverns
        - Interlocking crystalline feature that is highly porous
        - E.g. Strathcona Salt Cavern Storage project in Edmonton
    - (2) Depleted mine
        - Mine space where minerals were removed
    - (3) Aquifers
        - Subterranean water
    - (4) Depleted reservoir
        - E.g. an o/g reservoir that is fully depleted
    - (5) Hard rock caverns
        - Usually close to the surface
- **Why store gas?**
    - Market purposes:
        - If is stored it can easy access the market when needed (produce low sell high)
    - Smooth out unpredictability in energy demand curve:
        - Can produce consistently but have a storage as an insurance policy in time of high utilization

***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 (gas placed in or under her property without her knowledge or consent)
- Issue:
  - Is Central liable in trespass for using the appellant's property?
- Reasons:
  - Oil and gas are not the property of anyone until reduced to actual possession by extraction
  - Endorsed the wild animals ownership theory: (Oklahoma approach)
    - 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 the property of the capturer
  - 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
    - So once the gas is released it 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 is an incentive for the o/g company to pay the landowner to not extract the gas
  - **Consequence of injection – you lose your possessory right, open for someone else to capture now**
- Holding: Central not liable for trespass; the gas ceased to be under their exclusive ownership when it was injected into the ground

***Lone Star Oil & Gas v Murchison* (1962 Tex Ct Civ App)**

Stored gas continues to belong to the gas owner who extracted it; opposite of Hammonds

- Facts:
  - Lone Star (appellant) injected **"extraneous gas"** (gas produced elsewhere, acquired and owned, reduced to personal possession, then injected for the purposes of storage) into the Bacon storage reservoir underlying about 4,000 acres in Henderson County
  - Appellee sought or began to use the gas that was injected into the reservoir
  - Lone Star then sought damages and redress for the conversion of gas which they contend is their personal property
- Issue:
  - Did title and ownership of the extraneous gas that the appellant acquired and stored in the underground reservoir for use pass from appellant to appellees?
- Reasons:
  - Court did **not apply *Hammonds*** and said that the **wild animal or water analogies do not translate to oil and gas**
  - 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
    - <u>Abandonment requires intent to abandon</u>
  - 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
  - Since the gas owner is still the owner of the gas (title not lost), there could be a successful action in trespass by the surface owner against the gas owner
    - Either way the gas owner will receive compensation (for trespass or to ensure they do not begin to extract the gas)
  - Court does not endorse Oklahoma theory – uses absolute ownership with some limitation
- Holding: the owner of the gas does not lose title thereof by storing the same in a well-defined underground reservoir

<u>AB's Legislated Storage Scheme</u>

Mines and Minerals Act

- **Injection wells:**
  - S. 56(1): subject to section 57, a person has
    - (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…
      - Need approval to use a well or drill from the Board
  - (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 of that right
- **Ownership of storage rights, etc.**
    - S. 57(1) subject to subsection (2)
        - (a) where a person owns the title to petroleum and NG in any land, that person is the **owner of the storage rights with respect to every underground formation** within that land, and
            - Where there is no split title the owner receives storage rights on that land
        - (b) where one person owns the title to petroleum in any land and another person owns the title to the NG 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 the cavern storage space
    - (3) A person who has storage rights in respect of a subsurface cavern within any land **he 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
        - If you have a valid storage right you can exclude others from removing fluid from that storage cavern

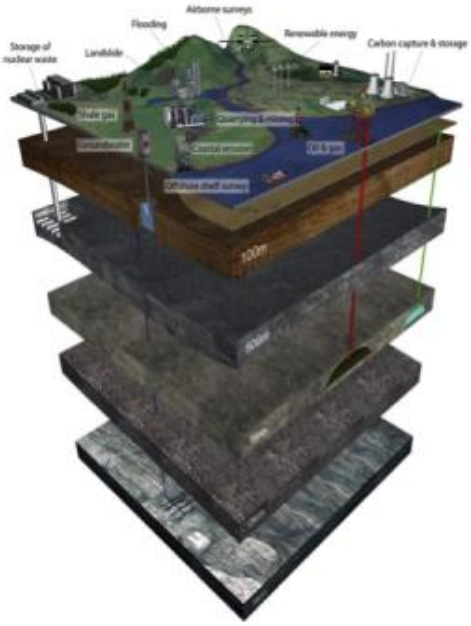
NOTE:

- **Who owns the subterranean caves?**
    - The surface owner
    - The legislation does not *expressly* take away this property right, so the surface owner would get a natural cave
        - There is a presumptive right to compensation upon removal of a property right
        - Legislation is not retroactive unless it expressly indicates so
    - To overrule this would require express statutory language
- **What constitutes a mineral?**
    - In some jurisdictions limestone is a mineral, and in others it 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

CARBON CAPTURE AND STORAGE

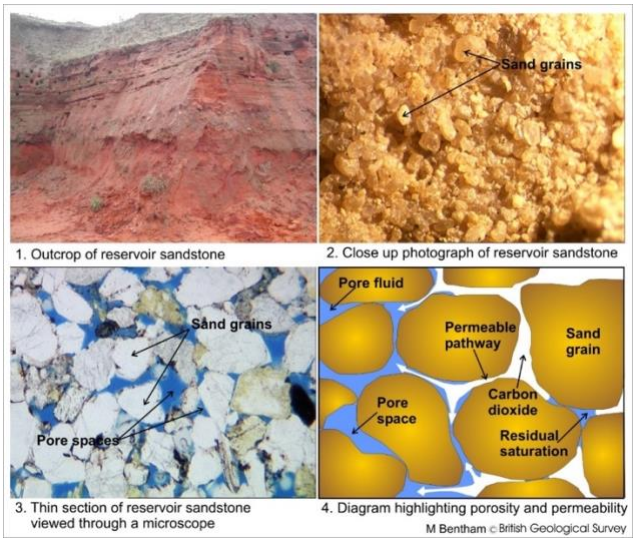
Overview

- Carbon capture and storage was AB's big bet for mitigating climate change
- **What is it?**
    - Gasses that contain CO2 mixtures are stored at considerable depths in the ground in stable formations that don't allow the gasses to escape
    - During the development extraction process, any greenhouse gases created are separate and transferred into a pipeline, which leads to an injection well, and then underground to a stable formation
- **Where?**
    - Two facilities in AB
    - AB spent over $1 billion on this, but it hasn't proved as efficient as initially thought
    - Problem: where to deposit the greenhouse gases in the ground? Goal is to put them in pore space in sedimentary rock



What is Pore Space?

- Could be sandstone (rock that can crumble/break apart)
    - These are pore spaces between sand grains
    - Essentially interstitial space
- Between the pore spaces are **permissible pathways**
    - These can be filled



CCS Issues

(1) Climate change

- Instead of saying we will eliminate the processes to achieve reductions in CO2, CCS would allow for the capture of CO2 and safe storage
- To make it work the government has to be able to find storage space that is suitable

(2) *Carbon Capture and Storage Statutes Amendment Act, 2010*

- Amendment to the MMA through the CCSSAA
- **Sec 15.1**
    i. (1) It is hereby declared that
        1. (a) **no grant from the Crown of any land in AB,** or mines and minerals in any land in AB, 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
        2. (b) the pore space below the surface of all land in AB is vested in and is the property of the Crown in right of AB and remains the property of the Crown in right of AB

    ii. (3) The Minister may enter into agreements with respect to the use of pore space

    iii. (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

    iv. (5) **No person has a right of action and no person shall commence or maintain proceedings**
        1. (a) to claim damages or compensation of any kind, including damages or compensation for injurious affection from the Crown, or
        2. (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

- **NOTE:**
    i. Crown declares retroactively that it owns all pore space in the province, and no grant can interfere with pore space

    ii. Says this is NOT expropriation, meaning no compensation is payable

    iii. Problem:
        1. **(1)** says *all* pore space, makes no differentiation, isn't there a potential to disrupt the land? The gov't says no, to be effective the injection has to be hundreds of feet down, far below o/g;
        2. **(2)** what if the gas doesn't stay there? Gov't has created a liability fund that it manages to try and deal with intergenerational possibilities

iv. This is a very unique piece of legislation – to retroactively carve out pore space and grant to government with no expropriation is a radical departure from what we usually see with mineral rights
    1. Remember: "Despite what we might think, property rights can be interfered with at the will of the Crown"

(3) Post-amendment conflicts

- May be conflicts in the future, e.g. o/g companies wanting to develop a resource in close vicinity to pore space, where 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

INTERESTS UNDER THE LEASE

The Problem

- "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 the owners of the 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 have leases in the first place and not outright ownership?**
        - **Energy Co:** has the money but can't afford a land inventory, difficult for a company to start purchasing mineral rights for every area they might want to develop
        - **Owners of mineral title:** don't want to sell because there could be an opportunity cost (higher valuation than they initially think, fluctuation of the market)

The Lease Response

- Typically, the **lease provides for an energy company (lessee) to pay an owner (lessor) a sum of money (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 lease substance** which may be found to exist beneath the lands until these substances are depleted
    - Time period is usually 5-10 years
    - If they find something, the lease allows you to main production until depletion (second term); landowner also gets a royalty
    - Helps mitigate risks on both sides
- The right to produce is **coupled with an obligation to pay the landowner** 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)
    - Could be bad for the owner – may not be getting much from the delay rental
    - It is in the lessor's interest to have the resource developed by the company, because this is where they really profit
- Overall: the lease structures the relationship between the lessor and lessee because of the unique relationship created to maximize benefits on both sides
- **Two 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
        - Government holds the power here, and not much is negotiable/not very flexible because most rules are set by Regulations
        - Because development is for the "public benefit", this is why we periodically see royalty reviews to try and maximize returns
    - **(2) Freehold Leases**
        - Corporate ownership directs its form, and lease terms are dictated by the lessee and not the resource owner. Often, developments and changes to the standard form will benefit the resource owner
            - Power usually held with the corporations – they will approach resource owners and try to extract beneficial arrangements
        - As stated by Professor Merrill (US): "The lessee comes armed with a printed form, the product of legal and business experience"
            - Corps are in the beneficial negotiation position – they usually have experience in the field, so the process is driven by the lessee
        - Interpreted as if the parties had equal negotiating power creating the lease
            - This is how courts will interpret, but is not accurate
        - '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
            - Quite lessee friendly – ultimately replaced

- Canadian Association of Petroleum Landsmen (CAPL) + Natural Resources section of the CBA produced the CAPL lease. Now known as CAPL 99
    - This is a boilerplate form – start with this and then manipulate it to make it fit the circumstances
    - CAPL has been an attempt to respond to many historical issues that have arisen
    - An o/g lease could technically sit in abeyance for 30 years and then have a legal issue arise, which creates very interesting legal questions

Berkheiser v Berkheiser **(1957 SCC)**
Petroleum and NG lease is a profit a prendre; reversionary interest (remaining o/g) belongs to the bequest of the will; no severance in title from a profit a prendre / o/g lease

- Facts:
    - In the last few years of the testator's life, she took several actions. In 1947, she left a quarter section of land in her will to the appellant. In 1951, she leased the petroleum and NG in the same quarter section to an incorporated company for a period 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 NG (including the acreage rental payment), while the respondent claims it should go to the residual beneficiaries (they are residual beneficiaries). They say the benefits that accrued under the lease (royalties) should go to them because of the severance.
- Issue:
    - Who owns the mines and minerals that were leased?
    - To whom does the acreage payment belong to?
- Reasons:
    - Why an o/g lease is more like a profit a prendre than a normal/true lease:
        - The resource in question is used, and the property is substantially different after the terms of the lease
        - So more like a profit a prendre or an irrevocable license to work and win
    - Although called a "lease", a PNG lease is more like a profit a prendre because there is an <u>incorporeal right</u> to explore and work the land for the petroleum and NG
        - When a profit a prendre expires, the land goes back to the owner minus what has been taken out (may be nothing, or a portion)
        - This was a grant of a profit a prendre for an uncertain term, which may be brought to an end upon the happening 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 and the reversionary interest in the petroleum and gas falls to the appellant (lessor)
    - Argument by the respondent 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) – basically that the gift no longer existed
        - This type of severance from a will is known as **<u>ademption</u>**
            - 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**
            - Title was not severed because the reversionary interest remains with the mineral title owner – at the determination of the lease everything reverts back to the title owner
- Holding:
    - The fruits of the NG lease belong to the appellant surface rights holder (to whom mineral rights were bequested in the will)
- Importance:
    - Sets future understanding that an o/g lease is not a true lease for most purposes, nor is it creating a transfer of fee simple
    - It creates a profit a prendre which gives a right of taking to extract or alter, or an exclusive license with a right to work or win
    - O/g lease becomes understood as unique legal subject matter

Remember: *Land Titles Act* – "for the purposes of the LTA a PNG lease is a lease"

***IFP Technologies v EnCana Midstream and Marketing* (2017 ABCA)**
Contract interpretation approach

- Gives application of *Sattva* for applicability in understanding oil and gas disputes
- Allows for contextual analysis (brings in context to allow understanding)
- Flexibility in context operates to limit the ability of the appellate court to alter decisions based on facts

SUBSURFACE DISTURBANCES

BLOWOUTS

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 may result in the release of toxic sour gas
  - Can be very significant and have lasting and permanent damages
  - Basically: rapid depressurization and unrelease, often coupled with an explosion
- **How common are they?**
  - Less common than they used to be; pressure control technology is much better
  - Still happen every few years in AB
  - Can affect properties 20 kms from where the blowout occurs, and the gas can have health consequences and cause loss of life
- **State of law?**
  - American jurisprudence differs from Canadian approach
    - American: litigation
    - Canadian: regulatory intervention, asserts ownership and deals with the resource through a quasi-expropriation

***Elliff v Texon Drilling Co* (1948 Tex Sup Ct)**
Negligent waste of o/g from shared reservoir; rule of capture does not apply to blow outs (limits to the rule)

- Facts:
  - Petitioners Elliff owned the surface and royalty interest in the land subject to o/g lease
  - Failure on one of the well sites on TDC (defendant) land that led to the well blowing out, cratering (surface collapse), which expanded and subsumed Eliff's well, which also blew out and cratered – led to large quantities dissipating from the reservoir
  - Elliff:
    - TDC caused the blowout through their negligence, which wasted the o/g that they would have otherwise recovered. They also had a royalty interest in their land and now they would not receive the royalty rate on the o/g that was wasted
  - TDC:
    - Claimed they were entitled to take from the pool because of the rule of capture – shouldn't be liable because the plaintiffs did not obtain ownership of the o/g until they reduced it to possession
  - Trial court:
    - Judgment for the plaintiffs for $154, 518.19, which included $148, 548.29 for the gas and distillate and $5,970 for damages to the land and cattle
  - Court of Civil Appeals reversed the judgment because:
    - Elliff could not recover because under the rule of capture they had lost all property rights in the gas that had migrated from their land
    - Recovery can't stand because the trial court had submitted the wrong measure of damages in that the petitioner's claim is for "trespass in and to a freehold estate in land and the proper measure of damages 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 o/g, recognizing that substantially all of the wastage occurred through the opening of TDC's leased land?
- Reasons:
  - Texas is an absolute ownership state where a landowner is regarded as having absolute title to the o/g beneath his land (*in situ* ownership) subject only to the law of capture. **BUT capture means *reasonable capture* and does not include a blowout**

        - **Limits to the rule of capture:**
            - **(1) unreasonable actions not covered**
            - **(2) operations are subject to limitations from state regulators**
        - 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 the defendants were working the resource was not reasonable
        - This situation is compensable
    - Only two limitation on o/g ownership in Texas:
        - Each owner is to be afforded:
            - (1) A reasonable opportunity to produce his proportionate part of the o/g from the entire pool; and
            - (2) Has a duty to prevent operating practices injurious to the common reservoir
    - **What is the remedy?**
        - (1) Trespass – argues damage to the land. If trespass is the action, then damages will be measured by the difference in market value to the land before and after the trespass
            - But usually you need *direct physical interference* with property, which was not technically present here
        - (2) Conversion – wrongfully gaining and using another's property for a non-permitted purpose
        - The court did not specifically say which theory determined the damages
- Holding:
    - The defendants were liable for the 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 the common reservoir

NOTE: what is a blowout happened in AB – can we transpose this American reasoning?
- If there was a cratering event on your land, could probably claim nuisance
- Potentially trespass if substances were deposited on land
- Conversion is unlikely – fluctuating price of o/g, can't convert something in situ
- Negligence would likely be your best bet (based on the value of the loss occurred, i.e. wasted OG and unrealized royalties)

***Atlantic Claims Act, 1949, the Regulator's Role, and the Settlement Process* – Alberta Approach for Blow Outs**
- Blowouts are not in the public interest because they sever the ability for individuals to get their entitlement from the reservoir, and from it to fully produce what is possible
    - Bad for efficiency
- AB had a large blowout from a well in 1949
    - Atlantic Oil Co was described as a non-descript semi-bankrupt oil company known for cutting corners in safety
    - When the blowout occurred, oil gushed for six months and then burned for six months
    - No litigation, but 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: **more likely to see a regulator intervene (as opposed to litigation) and punish the wrongdoer and compensate those individuals who 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
- **Trust fund 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?**
    - Sec 3(1) – Board can pay out money over two years for any settlements that arise
    - Sec 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) – adjacent developers can argue they have a right for damage done to their property – this money can be used to give effect to these settlements
    - Basically: end up with an out of court dispute resolution process that allows settlements to be reached between company and claimants
        - Any parties that have interests that can argue their access to the resource was diminished or impeded
- **How was the company punished?**
    - Board deemed the Atlantic well to have overproduced by 565,000 barrels

    - Sec (4): Board can (1) restrict production in the company's other wells; and (2) prevent further drilling – not allowed to exceed a certain amount
- **Overall**: punitive for company, restrictions placed on company to access the shares pool, and creates a dispute resolution mechanism to compensate those affected by the negligence
    - But for a major disaster in AB we would still likely see some litigation

Lodgepole Amoco Sour Gas Blow Out, 1982

- Some blowouts are more dangerous to human life, like sour gas blowouts
    - This one blew out for 68 days; multimillion dollar damage
- Big concern in rural AB – how much time to people have to evacuate? What is the emergency response plan?

Interim Guidelines for Resident Compensation, 1989

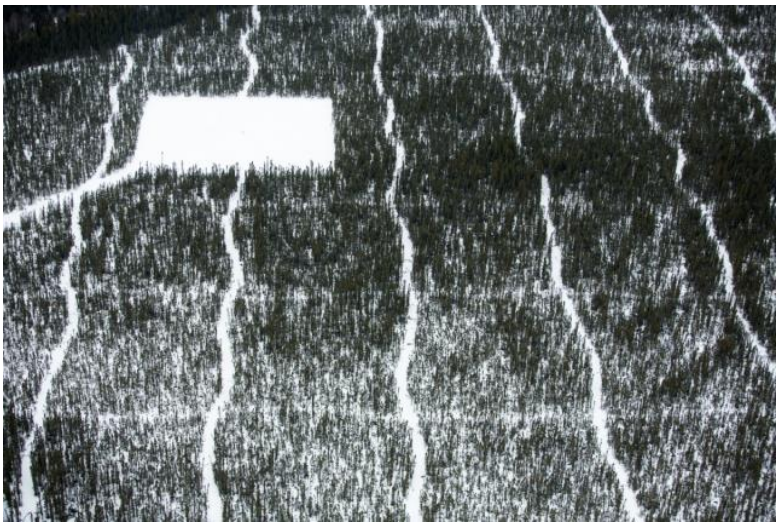
Guidelines on process for compensation when there is a blow out near your property

- Drafted with participation of industry
    - Canadian Petroleum Industry (CPA), Independent Petroleum Association of Canada (IPAC) and the Pembina Agricultural Protection Association (PAPA)
- Goal: fair and prompt compensation for those who are directly affected by a blow out
- **Three-tiered approach:**
    - (1) Immediate out of pocket costs
        - No dispute to cause and effect
        - Direct result of a temporary relocation necessitated by an uncontrolled blowout
        - E.g. costs of hotel accommodation, meals
    - (2) Costs directly related to the uncontrolled release of H2S
        - For direct damages clearly caused by the release of sour gas
        - E.g. caring for house, barn, outbuilding during evacuation period, death of livestock
    - (3) Costs associated with longer term impacts where cause and effect are unclear, and which may require considerable documentation and investigation to verify
        - Could be significant for landowners concerned about the long-term viability of their land/business operations
- **Dispute resolution process for damages within the tiers**
    - Negotiation: parties submit the matter to an independent mediator who assesses the merits and recommends an award (not binding)
    - Arbitration: decisions are binding and generally not subject to appeal – may be more expensive
    - Litigation: this report dissuaded individuals from using litigation – says it is time consuming, costly, and unpredictable
        - Self-serving document that discourages lawyers/litigation – because at this point the result cannot be controlled by the companies

GEOPHYSICAL EXPLORATION

Overview

- This picture is of a well pad and access road, and seismic lines cutting through the forest for exploration to determine drill location
    - Seismic testing gives information about subterranean features, and what the reservoir looks like underground
- Has since been replaced with low impact seismic exploration (better for the environment)



- Seismic exploration uses energy pulse transmitted into the ground with a mechanical device (vibrator truck or explosive energy)
    - When different rock formations are encountered, energy is reflected back to the surface and recorded with a hydrophone
    - Waves bounce back at different rates/angles based on subsurface features
    - Based on this data you get an "underground picture"
- Geophysicists interpret recorded signals to show existence of oil and gas deposits
- Impact:
    - Many historic exploration lines remain visible on landscapes and can impact wildlife
    - E.g. caribou need intact forest to survive, hunters could use the roads as a "highway" through the forest to hunt
- **Traditional approach:**
    - Create seismic lines, send out trucks to dig holes and ignite dynamite, register vibrations coming back, computer model provides picture of subsurface
- **Low impact seismic:**
    - Uses smaller equipment, create narrow path on which hydrophones can pick up seismic vibrations
    - Two-meter paths (instead of eight) going in a curvy formation that don't create wide "highways"
    - Allows for smaller footprint and impact, especially with heli-portable operations
    - Today this is the standard
- Problem: does seismic exploration count as a trespass? How to 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, but the surface owner did not own the mineral rights beneath the 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 grant the right to explore the mineral estate? Is there any cause of action?
- Reasons:
    - **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 strange rule to allow the owner of an entirely different estate (the surface) to reduce or sell the right to reduce to a certainty and thereby change the whole basis of the valuation of this info belonging to someone else
        - **The right to explore for minerals has a *considerable monetary value***
        - Geophysical exploration gives certainty – goes to the value of the estate
    - Defence: appellants were merely seeking info for the minerals under the adjacent land, which they owned
    - **Trespass:**
        - Trespass is a *direct interference with someone else's property.* It is an action that does not require any damage
        - Court called this a geophysical trespass because the shockwaves shook up the m&m
        - Damages calculated via difference in m&m before and after the trespass (usually nothing because minerals just rattled)
    - **Waiver of tort (assumpsit):**
        - Recovery in assumpsit is based on an implied promise whose assumed terms should conform fairly closely to the sort of agreement that might actually have been reached by reasonable parties
        - Rather than sue for trespass (where damages could be zero), a party could seek recovery of the benefits received by the wrongdoer (i.e. reasonable FMV of the use and occupation of the property) – what would have been received if there had been a legal contract created
            - Here the plaintiffs brought an action in assumpsit
    - **Compensation**
        - Compensation need only be paid 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 been created
        - Can look to the pattern of exploration which can delimit a serious of continuous areas in the scope of the survey
        - *Don't have to pay for the full area of land*
        - Overall: **reasonable cost under such an agreement**

- Holding:
    - The right of exploration is normally attributed to the m&m owner. Permission must be obtained from the m&m owner.

NOTE: does this work in Canada?
- Depends if an assumpsit action is available (we don't always have a clear tort for this)
- In AB we don't see this issue arise as commonly because of exploration regulations, which stipulate that an explorer must obtain the consent of the owner of the land as well as anyone else whose consent is lawfully required

Regulatory Requirements in AB

Mines and Minerals Act
- **Exploration:** in relation to petroleum and NG, exploration means
    - (a) any operations on or over land or water to determine geologic conditions underlying the surface of land or water, and
    - (b) any operations that are preparatory to or otherwise connected with the operations
    - **Sec 8:** no person shall conduct operations (a) on private land, except with the consent of the owner of the land or a person authorized to give that consent; or (b) on land owned or occupied by the Crown
    - **Sec 8(3):** subsections 1 and 2 shall not be construed as removing the necessity to obtain a consent to conduct exploration on any land from any person not referred to in those subsections if that person's consent is required by law
        - **Overall:** consent for exploration is required
- **License:**
    - Need a license to conduct exploration activities (s 107)
- **Approved exploration program:**
    - Exploration has to be conducted in accordance with an approved exploration program

Exploration Regulation 284/2006 (M&M Act)
- Consent from owner for exploration is required (s 8)
    - Owner likely means surface owner – but likely need permission from both the surface and mines and minerals owner
- Deals with unique exploration circumstances that may arise:
    - E.g. different types of public land, public land encumbered by a grazing license, municipal districts, etc.

If consent is denied:
- Example: severed title where mineral title held by o/g company but surface owner refuses to give consent
    - Remember: can get access for exploitation (removal of minerals) from the Surface Rights Board, but **can't do this for exploration – need consent from landowner**
- Option:
    - Main route around is sec **8(4)** - use Crown land – **road allowances**
        - A road allowance is a 66 ft reservation owned either by the Crown or municipality
        - Crown controls easement-type access through road allowances
        - Can get approval that sidesteps the need for private approval or municipal district approval and gain access to exploration on the road allowances that the government owns

***Phillips v California Standard Oil Co* (1960 ABSC)**
Oil company liable in nuisance for shock waves impacting water well; not found to be trespass
- Facts:
    - The plaintiff owned a quarter section of land on which he sunk a 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:
    - What is the cause of action? What are the damages?
- Reasons:
    - Trespass involves **physical entry** onto the property of another – here there was no physical entry
        - Vibrations transmitted onto the land do not in law constitute a trespass (does not count as physical intrusion)
    - Can plead **nuisance instead** (interference substantially with an amenity on the property)
        - Vibrations created a nuisance, which created damages. This is what is compensable

        - Have to prove damage to property for nuisance
        - Need to show damages actually occurred and can be shown
- Holding:
    - The oil company was found liable for nuisance. Damages of $1500 were awarded to the plaintiff

***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 do seismic testing. Wife said her husband was out of town and gave his contact info
    - Without permission the company decided to go ahead onto their land and complete the testing
- Issue:
    - What is the cause of action?
- Reasons:
    - Can seek trespass here because there was a physical invasion and actual disruption to the land
    - Damages:
        - Can prove cost of clean-up, cost of loss of one animal that escaped, cost of rounding up cattle and repairing fences, and punitive damages
        - Costs awarded:
            - Loss of timber: $1777
            - Clean-up costs: $680
            - Loss of steer: $150
            - Punitive damages: $500
- **Importance:**
    - Practical lesson is that it is worth the risk to the company – just a cost of doing business
    - Disadvantage between the parties is significant – power, money, expertise

HYDRAULIC FRACTURES

Overview:

- This process has helped make previously unconventional methane resources conventional in nature because it increases their ability to flow
- Practical implications: can change the seismic activity of an area (uptick in earthquake frequency)

***Coastal Oil & Gas Corp v Garza Energy Trust* (2008 Texas)**
Lessors have standing in action in trespass (applies to non-possessory interests like reversion); but fracking can't 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 gas formation
    - Resulted in physical invasion of neighboring Tract B (owned by Salinas – oil and gas lease with Garza Energy Trust) and the drainage of hydrocarbons to well on Tract S
        - 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
    - Note: three lengths of hydraulic fracturing: (1) hydraulic length – how far fluid can extend underground; (2) propped length – how far proppant can extend; and (3) effective length – length at which the actual opening up of the reservoir will allow the gas to flow
        - Here all three lengths extended beyond the property boundaries of tract A into tract B
    - As mineral lessor, Salinas have royalty interest and possibly reverter if the lease terminates, but no right to possess, explore for, or produce minerals
- Issue:
    - Can neighboring landowners (Salinas) take action against the company because hydraulic fracturing extended onto their property? Do lessors have standing to assert trespass (or do they need a possessory property right)? If fracking an actionable trespass?
- Reasons:
    - **Trespass:**
        - Salinas has standing for an action in trespass

        - At CL, trespass also included trespass on the case which was not limited to physical invasions of a possessory interest in land but also provided action for injury to non-possessory interest
        - Must demonstrate **actual permanent harm that affects the value of the interest**
            - Salinas alleged actual harm in the form of either reduced royalty revenues or loss of value to the reversion
    - **Can Salinas prove damages justifying a remedy? NO**
        - Hydraulic fracturing cannot ground an action in trespass; **precluded by the rule of capture**
        - Court doesn't want to interfere with this sort of mineral interference through a highly technical process
            - Salinas should have taken action through triggering development on their own property
        - Reasons not to change the rule of capture here:
            - 1) Rule of capture already provides full recourse to the owner who claims drainage (drill a well to offset drainage)
                - If operator isn't producing, you can force the lessee to commence action or kick them off and bring in another company
            - 2) While mineral rights owner has a real interest in o/g in place, the law of capture is recognized as property as well
            - 3) Difficult to determine the value of oil drained by fracking (below surface), and some drainage is virtually unavoidable
            - 4) Legislature has not seen fit to regulate fracking
- Holding: Salinas could not sustain a trespass action

NOTE: have we seen this in the Canadian context?

- Not yet. Would have to make the case that the physical invasion of water and proppant substances is sufficient enough and creates material damage to the extent that it should be compensated

CHAPTER 3: ACQUISITION AND CONVEYANCING OF INTERESTS IN OIL AND GAS

WHEN DOES A "LEASE" MEAN A PNG LEASE?

<u>Unique Nature of Oil and Gas</u>

- Oil and gas is a unique legal subject, but its conveyancing raises the same suite of issues as with the treatment of other real property (*Statute of Fraud*, *Dower Act*, etc.)
- Problems:
    - **1) Unique statutory provisions applicable to oil and gas**
        - When the statute speaks to "leases" but does a poor job of stating what lease qualifies
    - **2) What to do when an estate is involved (limited treatment)**
        - Contests between general beneficiaries and residual beneficiaries
        - When there is a life tenant followed by a remainderman
    - **3) Oil and gas and the Rule Against Perpetuities**
        - Important for grants made before July 1, 1973
- Consider:
    - **At CL, 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 extracting 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
        - This is advantageous – nothing here to frustrate commercial development, trying to move it forwards
    - **These common party contracts have been validated by s 10 Law of Property Act**
        - **10(1)** A contract is <u>valid and enforceable in accordance with its terms notwithstanding</u> 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
        - An o/g lease is a registerable interest with land titles too
        - Need to deal with these things before you transfer title

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

- Section 56(1) – broad definition of minerals
    - Helps to remember who owns what, who is contracting for the resource
    - Valuable stones are excluded and held by the Crown
    - Clay and marl are excluded – held by surface owner
    - Sand and gravel are excluded – held by surface owner

***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 Mayhood (1/4 interest), a collection of 8 nephews and nieces (1/4 total) and ½ to Mattern
    - Mayhood (executor of the will) died after Hayes, but before the full transition of mines and mineral 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 DRPA. **The lease was opposed by one of the nephews who owned a 1/28 interest in the mineral rights** (Hayes)
        - Argues that:
            - 1) At the time the widow sought lessees she was only a bare trustee and so had no power to dispose of the interest
            - 2) The Act did not empower the execution because it was not a sale of real property or a lease of real property
            - 3) The agreement was no in the interests and to the advantage of the beneficiaries vested in the estate
- Issue:
    - Did the "lease" qualify for the purposes of the Act? Could the executrix execute it and the court approve it?
- Reasons:
    - Remember ***Berkheiser*** – court ruled that PNG leases were best characterized as a profit a prendre or an irrevocable license to search and win substances named
        - Also held here that a "lease" of PNG is not a "lease" in the ordinary sense
    - In AB this has been modified by the *Land Titles Act Clarification Act*
        - Says that a **lease includes an agreement where the owner of a mineral interest grants to another the right to take or remove the minerals**
    - Here – lease not defined in the Act, but when the word is used in s 14 it must have been intended that its application also intended to extend to leases of real property under the Land Titles Act
    - **How to determine:**
        - Court has to look to other pieces of legislation to find a broad reading of the term lease to extend not just to a true lease, but also to a lease for mineral exploitation like an oil and gas lease
    - The lease was a lease within the meaning of the Land Titles Act
- Holding:
    - 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:
    - Contests whether the agreement is to the advantage or in the interest of the estate/beneficiaries

- Held that the executrix did not take adequate steps to endeavour to dispose of the property, even assuming she had the right to do so
    - She could have undertaken a geological study to determine the value of mines and minerals, or canvas for opinions on the productive capacity of the property and seek out more buyers
    - Failed to include a term in the lease that would force the oil company to develop the resource or protect drainage of estate lands to neighboring wells, which does not maximize benefit to the beneficiaries

NOTE:
- The Devolution of Real Property Act has been replaced in AB by the Estate Administration Act
    - 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**

LIFE ESTATES

Overview
- Typical prairie will:
    - "I leave everything to X to enjoy for so long as they live or until they remarry (life estate). Upon their passing, everything passes to Y"
- 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 Sask QB)**
If there is an o/g lease entered into AFTER the death of the testator then need consent by life tenant and remainderman and money from development is put into a trust account. If lease is BEFORE death then intention that all benefits pass to life tenant
- Facts:
    - Myrtle Moffat is a life tenant, and her two sons are remainderman for the m&m royalties pertaining to leases on two portions of land in the same section. Three oil wells were drilled on the land and the leases were entered into with oil companies to produce oil **after** the testator died
- Issue:
    - Who should receive royalties: life tenant or remaindermen?
- Reasons:
    - **English CL:**
        - Minerals (irreplaceable) should benefit the person who is intended to eventually take the ultimate interest in the property (remainderman)
        - **If the lease precedes the death of the executor:** the person with the life estate could continue to operate and benefit from those mines
            - All of the money could be used at the life tenant's discretion
    - **Application**
        - The remaindermen are 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
            - Remaindermen cannot work the minerals without the life tenant's consent, nor can she drill for oil on the lands. **Both parties need to consent to the operations**
            - The life tenant and remaindermen may jointly execute a valid lease (and decide between them how to divide proceeds)
        - Life tenant can also claim income earned on the proceeds derived from the m&m leases
        - Money from the development has to be put into a trust account because money is the proxy for the resource
        - What is the "fruit"?
            - It is the interest produced on the invested money
            - The life tenant gets access to that invested income on an annual basis, but can't destroy the substance of the trust
            - Main lump sums of money stay invested for the remaindermen – life tenant can access income generated on investment
            - When life tenant passes, money transfers
- Holding:
    - 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.

NOTE: analogy explanation

- Mother gets the bounty from the land on a year-to-year basis
  - Limit: she can't destroy the crop or tear down the orchard (she has it in trust)
- Difference between o/g and apples – apples grow back
  - Can have these leases – when you create them the money that comes out is going to be deposited into a trust, which will accumulate interest. The life tenant gets to benefit from the interest but cannot take away or destroy the capital
  - At the termination of the life tenant's life, the whole capital transfers to the reminder person

PERPETUITIES

The Perpetuities Problem

- ***Canadian Long Island Petroleum 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 on alienation* which is regarded at CL as a public evil"
  - Basically:
    - Avoid fettering interests, indirect restraint on alienation
    - Restrain individuals from being able to limit future purposes of land by adding contingencies before land is vested with another party

- **This 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) ***Interests 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 substantially amend their own lease as soon as it is topped because it is frozen in time by the subsequent interest caveated on title
      - Top lease can be used by the lessee to provoke the first lessee under the original lease to prove or substantiate the validity of the lease
      - This acts as a "trigger" to make you prove the lease, otherwise it could be vacated
      - Overall: commercial advantages to top leasing property
- **Common Law Rule**
  - No future interest is good unless it must vest, if it 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 tenants – so means to vest no longer than 21 years after creation of the interest
    - Can try to circumvent by inserting a life in being clause
- **Vested interest**
  - Not subject to any limitation/condition on enjoyment except for the termination of a previous estate (i.e. reversionary interest may be subject to a life estate)
  - Three qualities of a vested interest:
    - 1) Recipient is ascertained
    - 2) Size of estate is ascertained
    - 3) Recipient does not have to do anything further for it to vest (no conditions precedent)

Modification (but not abolishment) of the CL Rule in AB by the *Perpetuities Act*

- **Sec 3: Not void by virtue of contingent interest vesting beyond the perpetuities period**
  - Conveyance not void if there is a *possibility* of vesting outside the period
  - At CL: if you could validly assert an instrument might violate, it is void ab initio
- **Sec 4: "Wait and see"**
  - Wait to see if the interest becomes vested before the period expires
- **Sec 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 does apply
- **Sec 18: 80-year statutory perpetuities period for commercial interests (including *profits a prendre*)**
  - Need to wait 80 years to see if the interest becomes vested

- **Sec 25: Common law applicable to interests created before July 1, 1973**
    - Look to CL when looking at any interest before this date (could see a challenge in 2021 with an instrument from 1969)

***Canadian Export Gas & Oil Ltd v Flegal* (1997 ABSC)**
Perpetual renewal clause in PNG lease found to violate 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 PNG lease and grant as "lessee". The lease was made in October 1964 and was for a term of 10 years
    - Contained a provision that on the expiration of the primary term the o/g company has the right to trigger a renewal on the exact same terms (brings the same instrument back into force – means the renewal clause could go on forever)
- Issue:
    - Was the right to renew enforceable by the lessee? Is the option clause void because it is contrary to the CL rule against perpetuities?
- Reasons:
    - Plaintiff's argument:
        - The rule is not engaged because it does not apply to option clauses, and even if it was engaged, the first two renewals must occur within the perpetuity period (21 years)
    - Defendant's argument:
        - 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 profits a prendre
    - Court:
        - The perpetual renewal option in this case actually **sterilizes** the land
            - Not like a landlord/tenant relationship where the option for renewal actually stimulates the relationship that is commercially advantageous by allowing it to continue
        - Compare to o/g instrument:
            - Not being maximized during the primary term (only getting rental payments, no royalty payments until production)
            - Lessee trying to manage their assets – don't want to lose the right to develop so they just allow this renewal clause to operate
        - **To permit perpetual renewal of a true lease stimulates development, while renewal of this profit (which only becomes necessary if there is no development) encourages sterilization of the land (considerable detriment to landowner)**
            - Court held that the RAP was violated
    - What about two renewals in 20 years?
        - Court says no – if something has the potential to violate perpetuities under the CL it is void ab initio
        - 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 support for applying the rule
- Holding:
    - The perpetual renewal clause for a PNG lease is subject to the CL rule against perpetuities. The lease is void for being contrary to the rule (interest may vest outside of 21 years)

***PanCanadian Petroleum Ltd v Husky Oil* (1994 ABQB)**
Perpetual option to renew lease void if not currently producing; follows Flegal

- Facts:
    - Two leases 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 term would be identical to the original lease in all aspects
    - There was production on the shallow rights lease, so lessee argued the renewal clause should not apply since it only comes into play if there is no continued production
    - **Argument of lessor:**
        - Although the shallow lease was in production, it was still subject to renewal to preserve the lease, despite continued production
        - Mere production was not enough to keep the lease alive. Since it offended the RAP, it was void
    - **Argument of lessee (Husky):**
        - Renewals of profit a prendre interests should not violate the RAP because they akin to renewals of landlord/tenant relationships, which are beyond the scope of the rule

        - *Court disagrees with this – follows **Berkheiser,** PNG leases are properly characterized as profits and not landlord/tenant*
        - *The right to renew a profit a prendre is not a vested interest*
- Issue:
    - Does this violate RAP? Does it apply despite production on lands?
- Reasons:
    - Shallow lease:
        - This lease was being produced – court says it does not engage the rule (yet) because the renewal is only required if there is no production
        - Lease has transitioned from its primary term into its production (secondary) term – uphold it on this basis
        - Nothing remains unvested
    - Deep lease:
        - No production – subject to the rule and struck down – encourages sterilization
        - Confirms analysis in *Flegal,* court says this is not the renewal of a true lease so can't take advantage of the CL exception
        - There are true condition precedents attached to the renewal clause which requires separate conditions to be satisfied which prove it is not vested
- Holding:
    - The renewal clause in both leases violated the rule against perpetuities; but the shallow lease did not engage the rule because the renewal clause didn't come into play since the lease was already under production
        - Renewal clause was only to be used when no production had occurred
        - Mineral lease was void by reason of the perpetual renewal clause violating the RAP (not producing)

***Pan American Petroleum Corp v Potapchuk* (1994 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 Scurry (defendant) that they have a subsisting lease for the m&m under Potapchuk's land. 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 Scurry gave the right to option a lease for the m&m on the land (Scurry had a top lease)
    - When Scurry tried to exercise his option, he could not because Pan Am held a pre-existing lease
    - Overall: lessee on bottom lease trying to say their lease is valid because production is happening on lands pooled with their property. But the wording of the lease doesn't allow that because for there to be deemed production, it has to be happening on the lands in question. Top lessee now challenging to say the bottom lease is invalid
- Issue:
    - Does the top lease held by Scurry violate the RAP?
- Reasons:
    - **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 here
        - *Gunderson* also 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:**
        - Scurry's five-year option was registered as a caveat on title in 1956. It was exercised in 1961, after the Pan Am lease had expired but before the five-year option period had extended
            - **Once a caveat has been registered on title, that prevents subsequent interests from being registered which derogate from that interest (caveat takes priority)**
        - The contract (modification to the lease) was drafted in 1960 which purportedly clarified what was meant by "active production" under the original lease. This was not a clarification, but actually a modification
            - **Since the modification occurred after Scurry registered his interest, Scurry's interest takes priority**
    - **Top lease did not violate RAP:**
        - Pan Am tries to argue that the Scurry caveat violates RAP because it would automatically be extended to any time that Pan Am breaks its lease – this is incorrect
        - 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 RAP because the optioner has the right to terminate the option at will**

- Holding:
    - In favour of Scurry. Defendant has a valid lease in the m&m 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 subsequently added to a lease will have the effect that the initial lease can no longer be modified
    - 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)

***Scurry-Rainbow Oil (Sask) Ltd v Taylor* (2001 SKCA)**
Top lease does not violate the RAP for policy reasons

- Facts:
    - In 1949, Taylor granted a 10-year primary term lease to Imperial Oil for PNG. The term was 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 Taylor granted a top lease for PNG on the same lands – provided the option could be exercised anytime within 42 years, and that the 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 RAP
- Issue:
    - Does the top lease violate the RAP?
- Reasons:
    - **Top leases:**
        - Common in the o/g industry – secondary leases which activate if an existing lease is repudiated or expires
    - **Purpose of RAP:**
        - The fundamental purpose of the RAP is to prevent the fettering of the marketability of property over long periods of time by indirect restraints on alienation
        - The rule applies without regard to intention – it does not matter if the parties agree to a contract which violates the rule, it is void ab initio
    - Top leases are accepted as normal business practice in the o/g industry because they **increase actual drilling and competitiveness.** Oil companies who have existing leases topped by other are more likely to drill the land to prevent a competitor from taking the lease
        - Because of this the **top lease does not engage the underlying rationale of the RAP since it encourages the economic development** of the land (doesn't clog alienation)
        - The RAP never contemplated top leases and it couldn't have been intended to apply to these types of transactions – so the rule is not violated
    - ***Archaic rules of CL must be re-examined in light of modern realities to determine if they should be modified***
- Holding:
    - Top lease held by Scurry is valid because it does not violate the purpose behind RAP
- Dissent:
    - The top lease violates the CL 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 RAP
    - Modification should be left to the legislature – not in the purview of the courts to put forward such a drastic change in law

NOTE:

- Part of the reason the court did this – 180 properties could be thrown into flux if they held it was invalid
- Could we see this outcome in AB?
    - AB has fairly conservative courts, meaning stricter adherence to CL tenants and principles
    - While this would be potentially possible in AB, quite unlikely – definitely not a guarantee

CHAPTER 4: THE FREEHOLD LEASE

OVERVIEW

Bishop vs CAPL 99 Lease

- Bishop lease: sets out all the traditional terms; less standardized
- CAPL 99: effort by petroleum producers in association with landowner interest groups to standardize lease language

Intro

- **True nature of freehold lease: *profit a prendre* (incorporeal hereditament) or irrevocable license to work (*Berkheiser*, etc.)**
  - But this could be changed by statute
- **Leases commonly survive through the primary term and well beyond by virtue of continued production**
  - Leases anticipate a lengthy term
  - Primary term – phase the lessee has to get working on the land
  - Secondary term – where you transition into production
- **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
- **Lessor and lessee interests**
  - Interests of lessor and lessee diverge
  - Lessor (land owner):
    - Main interest is usually a profit driven model, realizing production on their land so that their resource doesn't become susceptible to the rule of capture and so they get the main benefits of the lease
    - Royalties don't start until production is engaged
  - Lessee (usually oil company):
    - Generally has other broader commercial purposes and intentions in mind
    - Maintain a portfolio of land to allow them to develop what is feasible at the time, but also want to have other properties to start producing when they want
  - Pitted against one another in a way:
    - E.g. perpetuities – company wants options for ongoing renewals to determine when and where is advantageous to develop, or a variety of leases with less or more favourable royalty rights, going to develop down their own hierarchy to get the best return
- **Who brings the lease?**
  - Usually the o/g company
  - They bring the lease with the terms most favourable to their position
    - A long primary term (longer time to not produce); favourable definitions; good royalty calculation scheme
- **CAPL99 lease**
  - Call for lease standardization in the 1980s
    - Second major standardization form we have
  - Joint committee: CBA Natural Resources Selection + 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 ability as an owner
    - Take into account client's wants and needs

ANATOMY OF THE PNG LEASE

(1) The Granting Clause

- Lessee obtains rights to seek and extract the named substance(s) on the named land(s)
- Legal description of the **substances** and the **lands**
- What substances have been conveyed?
  - What is petroleum?
    - Liquid hydrocarbons?

- What is natural gas?
    - Solution gas? Evolved gas? Primary gas cap gas?
- Where does coalbed methane fit in?
    - 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
        - No info about the substances as named
        - Definitions quite small, room for ambiguity in interpreting substances being dealt with
    - CAPL:
        - Granting clause is using defined terms
        - Interpretation much more significant compared to what we see in the Bishop lease
        - This is a trend to use broad and strong interpretation section

(2) The Habendum Clause

- **Specifies, limits and defines the duration of the granted interest ("to have and enjoy")**
    - Primary and secondary term (extended/production term) will usually be defined
    - NOTE: the anniversary is midnight of the day before the lease expires
- **No Canadian CL definition of "production" - a sophisticated lessor/lessee will insert a definition**
    - Bishop lease:
        - No definition of production, but does define "commercial production" (different from bare production)
        - No description of operations, but has provisos that follow after the habendum
        - These provisos give gloss to the language of the habendum
        - Proviso 3: gives the grantee/operator additional leeway for what is allowed at the end of the primary term and transition into the secondary term
        - Gap between primary and secondary term where the actions of the operator are insufficient to maintain lease (if there is a gap, the lease terminates)

    - CAPL:
        - Definition of "commercial production"
        - Sec 1(j) defines operations, but quite broadly – very operator-friendly
        - In an ideal scenario for o/g development production is achieved in the primary term, then continues for the duration of profitable production
        - But for many o/g companies, production is started in the primary term, and then there are a variety of actions necessary to maintain the well and keep production going
        - Having broad definitions of operations allows the o/g company significant leeway to do what they need for operations and still have the lease survive
- **Common primary term lengths**
    - Primary leases give the lessee an opportunity to get their drilling operations underway – can be up to 40-50 years
    - Want them short if you're the lessor; likely 2-5 years
    - If a lessee, you want some flexibility of managing your profitability; likely 5-10 years
- **"…the lease will be extended so long as there are operations"**
    - An issue that will arise is getting a lease to extend
    - Leases will not be identical in how they transition from primary to secondary term
    - Need to focus on language that will allow a lease to survive
- **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 is 10 years
        - The extended term is how long the lease can continue after the primary term expires, i.e. "as long as the leased substances are produced"
- **Key takeaways**
    - Habendum clauses are of primary importance for the lease
    - Serves the role of setting down term for the primary term
    - Can contain language of what must occur before the transition into the secondary term is complete

CASES FOR HABENDUM

- ***Kinnimonth**:* habendum as a condition precedent to extend beyond 10-year term; habendum trumps proviso 3
- ***Murdoch**:* can repair a defect in a lease by normal contract (if there is no top lease)
- ***Cull v Canadian Oil**:* term said right to drill to completion with reasonable diligence. Court said they could *bring it into production with reasonable dispatch and diligence*
    - A lease with a capped well can only be kept alive by paying before the end of the primary term
    - A lease with a producing well can be kept alive by bringing that well into production with reasonable diligence and dispatch

DEFINING PRODUCTION

- ***Bearspaw:*** used the term "producible" = ability to make quantifiable amounts of natural gas, but does not require that everything be completed to bring the gas to market (i.e. a pipeline)
- ***Omers Energy v Alberta:*** "capable of production"
    - Capable of producing *meaningful quantities*
    - PRODUCTION TEST: would a reasonably prudent operator, for the purpose of making a profit and not merely for speculation, continue to operate the well in the manner in which the well in question was operated? (***Koontz***)

Habendum Proviso 1: Delay Rental Clause

- **Lessee to pay the lessor for the failure to drill a well within a specified period of time**
    - Delay rental gives you an option to make a payment in lieu of taking action to drill
    - During primary term the obligation on the lessee is to start drilling
- **If 5-year primary term, then 4 delay rentals**
    - Can't use delay rental payments to extend beyond the primary term
    - Primary term's purpose is to start development
    - Delays simply allow you to defer drilling operations – *still can't take you beyond the length of the actual term*
- **Strictly construed (question: can you mitigate with a default/breach clause? See clause 18 of Bishop lease)**
    - Bishop lease:
        - 10-year primary term
        - Possibly 9 delay rental payments that can be made
        - Anniversary date – when would you 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 the payment is not made, the lease automatically terminates"
            - If payment isn't made, the lease terminated
            - Default clause inapplicable
    - **(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. If they fail to do so, the lease terminates
            - Doesn't create a condition, creates a *contractual term*
    - **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 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**
    - Have to pay delay rental in lieu of production royalties
- Response to the reality that many wells don't get paid out (especially true in the 1950s)
    - Can't prevail yourself of the operations already done because they are unproductive – not something in itself to extend the lease
- Period of production doesn't ameliorate the operative ability of the rest of the term
    - Language of the dry well clause suggests that you have the last year to get operations going and successfully move into the secondary term
    - Just because you get production for a few years doesn't mean you lose the ability to take advantage of the operative clauses
- **Bishop lease:**
    - "If at any time during the primary term and prior to the discovery of production on the said lands, **the lessee 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 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 to 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 clause (*Kininmonth*)**
- ***Prima facie* enables continued lease existence without production; often litigated**
    - Problems:
        - Slight variations in the lease instruments challenge the ability for one of the parties to succeed as they want
            - Could be as simple as whether something speaks to "on" or "after" the expiration of the primary term
        - Any gap in the lessee's activity could be fatal to the continuation of the lease
        - Need to be clear about what conditions allow for the lease to continue – things incidental to production *might* save a lease (e.g. drilling), but this will turn on language analysis
- 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."

CASES

- ***Canadian Superior v Crozet Exploration Ltd* (1982):** if the lease *defines* operations and includes "operations for or incidental to any of the foregoing" can include preliminary preparatory actions as long as they were taken in (1) good faith (2) with reasonable diligence, and (3) more than simply minimal
- ***Kinninmonth* (1964):** proviso 3 here is subject to the habendum – requires production BEFORE it can be extended by production – habendum as condition precedent to extend beyond 10-year term ("at" vs "after" language)

(3) The Shut-In Well Clause

- **Purpose:** to **"deem production"** in the situation where the <u>well has been drilled but is not being produced</u> (i.e. actual production has ceased but the lease is maintained by deemed production)
    - If you have a completed well capable of production but it is not producing for the whole year, can continue the secondary term by deeming production through payment of an amount analogous to the delay rental (shut-in royalty)
- **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
        - *Lack of market*: bottom has fallen out of o/g prices, no demand to justify continued development
        - *Intermittent market:* highly fluctuating market, might justify shutting in the well to avoid being exposed to volatility
        - *Reasons beyond control:* AER order to shut in, significant natural disaster that required a shut in, etc.
- **Often litigated because it is a "catch all"**
    - Courts will look at the context and ask if it really is something unreasonable, or something sophisticated oil companies should understand (e.g. roads being washed out every season)
    - Part of the larger scale of action in the area might not allow the company to take advantage
    - Gives operators another way to not produce
- **Onus if challenged:**
    - Burden falls to the lessee to justify the existence of the condition
- **Trend:** strictly construed and requires timely payment – otherwise would unduly disadvantage the lessor
    - Anniversary date = usually before midnight of the anniversary date
    - But check the wording – does it actually expire at midnight or does the wording allow for a different interpretation?
- ****<u>How to examine every lease:</u>**
    - Must look at the shut-in well clause closely to determine:
        - **(1)** what is deemed production and how it is achieved;
        - **(2)** what constitutes timely payment; and
        - **(3)** what the prerequisites are to shutting a well
    - Deemed production must be achieved by the lessee <u>before</u> the shut-in royalty is paid to the lessor
    - The shut-in royalty must be paid <u>prior</u> to the anniversary date of the lease (but some liberalization of this in ***Cull*** and ***Durish***)

- 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."

CASES:

- ***Cull:*** gap between drilling and production, cured by unique language in cl 12 that allowed for the lease to be extended if drilling completed with "reasonable diligence and dispatch"
- ***Murdoch:*** lease can be extended by SIR payment as long as payment is made before expiry of the primary term – can't have a gap between actual and deemed production
- ***Hambly/Paddon-Hughes:*** gap without drilling or production/deemed production – included a cl 12 to fix *Kininmonth* problem but the shut in royalty was made after drilling was completed
- ***Kissinger Petroleum:*** shut-in was allowed to be exercised prior to shutting in and production because the shut-in payment was made *before* the actual shut-in was executed
- ***Durish:*** contractual dispute not "good oilfield practice"; SIRs are not obligations, they are options – default clause does not apply
- ***Teg Holdings:*** no access to carrier does not mean "out of their control" because could they have applied to ERCB; lack of intermittent market must be proven by producer
- ***Freyburg:*** shut in because of personal interest, claimed market even though they were producing other wells on the same field – test for valid economic market
- ***Kensington Energy v B&G:*** the 90-day period of proviso 3 is not read into the SIR. Deemed production is deemed production for the period during, and does not require continuous operations so long as it is shut in for a legitimate reason

(4) The Offset Well Clause

- **Lessor discovers that a neighbor has initiated successful well production – subject to rule of capture**
    - When a lessor discovers that the neighbor has a successful well and they are worried about that well draining 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)
- **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 neighboring properties
- **Bishop lease – cl 8**
    - Triggers a 6-month period to commence drilling on the land, or for the company to decide not to drill and vacate the premises
    - Then the lessor could ideally enter into a short-term primary lease with a new company and quickly trigger development
- **Laterally and/or diagonally adjacent (CAPL99 cl 6 vs Bishop cl 8)**
    - Bishop says "spacing units laterally adjoined" vs CAPL says "laterally and diagonally adjoining"
        - Lateral – just lateral (up/down/left/right)
        - Lateral & diagonal – also includes diagonals (encompasses more, this is optimal for lessor)
    - Makes a big difference because a subsurface reservoir could have the pool being drained under the diagonal property
    - More advantageous for the landowner because it gives them additional rights
- **When production is in a different strata**
    - If production is in a different strata there are usually no rights to trigger an offset well clause
    - E.g. you only have deep rights, they have shallow rights
    - Can't trigger because it is a different geological formation
- **"Commercial production" is defined – but not as favourable to the lessor**
    - 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 (they probably won't just tell you) so this clause is hard to trigger
    - Significant information imbalance
    - Just because you have ability to **recourse,** you don't have access to their records, so *can be 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**
    - Means that instead of having to drill on your land, your lessee could enter into a unitized or pooling arrangement for you to get the benefit of production from a field, without having to drill on your property. Two ways:
        - **(1)** Sign agreements that allow the lessor to get the benefits from the "pool" or the "unit" (CAPL99 cl. 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 cl. 6(d))
    - Way to account for efficient processes to drive production forward that don't need wells on adjacent or neighboring properties

(5) Pooling Clause

- Remember:
    - **Pooling:** combine tracts to form a DSU (voluntary or compulsory)
    - **Unitization:** combine DSUs to form a field (voluntary)
- If the lessee on your property has entered into a unitized agreement – lessee wants to make sure the agreement they have signed with you **allows production on pooled or unitized lands to count as production on your land**
- Typical pooling clause:
    - "Production on the pooled lands or unitized lands now counts as production on the leased lands" – this solves ***Gunderson*** and ***Potapchuk***
    - However, if you pool B's lands with three other parcels and paid him ¼ of the royalties, there is an issue. To overcome this, an amendment clause should be inserted: "the production from the said lands or land with which the said lands may have been pooled" (***Potapchuk***)

(6) Default Clause

- **Requires the lessor to give notice of the breach to the lessee, and is designed to prevent the lease from lapsing without the lessee being provided notice**
    - Applies to breaches, non-observance, and non-performance by the *lessee*
    - Provides the right to the remedy (IF they are obligations – otherwise no curative period available)
- **Delay rental and shut-in royalty – contentious section**

- Common interpretation is that failure to pay a delay rental or a shut-in royalty is NOT a breach = is only an *option*
    - If the lessee misses one of the payments the lessor is not required to give notice that the lease is now ended
    - In both scenarios the lessee never agreed to make the payments – both are condition precedents
- **Breaches only apply to *obligations, not options***
    - Typically construed as conditions precedent
    - If you can frame as an **obligation,** then if there's a breach of it, before the lessor can terminate the lease they would have to notify the lessee and give them the opportunity to rectify the default clause (engages default clause)
    - If an **option** (something the lessee can chose to exercise but not mandatory) – the default clause does NOT apply
- See Bishop lease cl 18

(7) Manner of Payment Clause

- **Requires the lessor to designate the depository that the lessee can make payments to – important because if the lessee fails to make payments of a delay rental or SIR in a timely fashion, the lease is dead**
    - Arguably an obligation, not an option
    - Different lease language often used (e.g. some allow mailing expressly)
- **A mailing clause may be included**
    - Poses problems
    - Postal rule – acceptance is deemed when it is in the mail – but not clear that this rule extends to payments
    - Does this extend to commercial transactions – some debate
    - **General rule:** payment made by mail is deemed to be received at the date of posting (***Paddon Hughes***)
- **CRUCIAL PART OF THE LEASE**

Lessor's Compensation Package

- What is the package of compensation the lessor is entitled to?
- **(1) Signing bonus – highly negotiable**
    - Certain amount of money as initial consideration for signing the arrangement
    - Recommend to client to get as high as possible
    - In Bishop granting clause - $1600
- **(2) Royalties – moderately negotiable** – o/g company has more knowledge/expertise so less negotiable
    - **"Gross royalty of 12.5% of leased substances"**
        - Gross royalty = not taking into account the cost of production (want to limit the ability of the lessee to account for deductions)
        - Net royalty = could include other costs, so lessor is paid profit minus upgrading, transportation fees, etc.
        - As lessor: don't want a net royalty because then the lessee could reduce the royalty for transportation and refining costs
    - **Paid for preceding month's production**
    - **Current market at the wellhead (usually not a problem for oil, which is sold pre-refinement)**
        - For oil this is not an issue – oil that comes out can be marketed and sold in that state (same as what comes out of wellhead)
        - For gas – more common for NG production to be mixed with sweet/sour – more costly
        - Issue: why is current market value used instead of the selling price (the price that the lessee sells to the refinery)?
            - Often the lessee will own the refinery that they are selling the oil to, so the selling price would be too low
    - **If the well produces both sweet/sour gas – Jumping Pound Formula**
        - More complex because generally gas must go through more refining costs prior to sale
        - Gas usually must be upgraded before it can go to market, so there is a *different formula* for determining the wellhead price of gas as compared to oil
        - **Jumping pound formula:**
            - Allows for certain key deductions to be made before the royalty payment occurs (less wiggle room for this for oil)
            - 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
    - Note: in ***Acanthus*** the court accepted that the costs of bringing o/g to market could be properly borne between lessor and lessee (this included for oil and NG)
- Example: Bishop lease cl 2; CAPL99 cl 4

Anatomy of a PNG Lease – Summary

1) **Granting clause**
    a. Legal description of the substances and land
2) **Habendum clause**
    a. Primary and secondary clause
3) **Habendum provisos**
    a. Delay rental; dry well clause; continuous operations/development clause
    b. Have to be read within the chapeau of the habendum
4) **Shut-in well clause**
    a. Shows what is deemed production, what constitutes timely payment, and what are the prerequisites to shutting in a well
5) **Offset well clause**
    a. Can potentially allow a landowner to trigger development on their land if there is production laterally or diagonally
6) **Pooling clause**
    a. Allow your specific land under the lease to be pooled or unitized with other producers for efficient development
    b. Should mean that production occurring on another tract of land will be deemed as production on your land
7) **Default clause**
    a. Meant to operate in situations of non-observance or contractual breach, give opportunity for lessee to have curative period to correct what is wrong
8) **Manner of payment clause**
    a. What money will be delivered where and at what time, using what method

****Any of these clauses could lead to frailties in the lease and/or ambiguities in language that could be litigated and result in a dead instrument = very expensive repercussions**

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 due date, so within the prescribed time in the lease

- Facts:
    - Pancontinental 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 passed with Pan.
    - Issue 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 if no production was occurring (P required to start drilling or pay delay rental payment). Neither lease was producing.
    - Pan claims that the cheques were mailed in the prescribed form on Aug 9, but the bank did not issue a notice of receipt until Aug 26 and Sept 4
    - NOTE: delay rental payments must be received by the annual anniversary of the creation of the lease (prior to midnight of the day preceding the anniversary day)
- Issue:
    - Were the delayed rental payments made within the one-year time period to allow the lease to continue?
- Reasons:
    - The Bishop lease specified that mail was an appropriate method of payment, implying that payments are received when they are mailed (i.e. Aug 9) which occurred prior to the 1-year period (so the lease is valid)
    - The Thatcher lease did not specify when payments would be considered received, or the required method
        - While the lease did not specify whether payment would 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 and the commercial reality**
        - The clause was interpreted by the court as indicating that the mail payment was effected by the **date of mailing**
        - Pan had done what was required of it under cl 21 – delay rental payment to Thatcher at the address specified

- Holding:
    - Date of mailing the payments was before the due date so the delayed rental payment were made within the time prescribed by the leases
- Dissent:
    - Mailing a payment was differentiated from the typical postal rules of offer and acceptance – the Thatcher lease was silent and other jurisprudence indicates that a payment is not made until it is *received*
    - Under ordinary law, mailing is NOT payment
- **Ratio**:
    - Even where mailing is not expressly stipulated in the lease, if it accords with parties' business intentions and the language of the lease, mailing of the delay rental payment before the anniversary date constitutes timely payment
        - Majority construed offer/acceptance broadly
    - Practical notes:
        - A lot of time and effort goes into negotiating instruments – if the lease fails over a $53 cheque to keep the lease alive this is very poor legal work
        - Have a detailed payment clause that specifies exactly when, where and how payment will occur

2. THE HABENDUM & CONTINUOUS OPERATIONS

***Canadian Superior Oil Ltd v Crozet Exploration Ltd* (1982 ABQB)**
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) on July 31, 1975. Primary term was to expire at midnight on July 30, 1980. Crozet had the top lease
    - On June 4, 1980, CSO granted an option to drill on the leased lands to Surf – Surf exercised that option on July 22, 1980
    - On July 24th surveying finished, rainfall required Surf to bring in gravel to stabilize, etc. Rigging up commenced on July 30th and well license issued that day. Derrick raised to vertical position and spudded in on July 31st
    - Habendum clause allowed the primary term to be continued as long as **operations** were conducted on the lands
        - **Key:** primary term + operations (NOT production)
        - Operations defined as: drilling, testing, completing, reworking...OR operations for or incidental to any of the foregoing
- Issue:
    - Was the lessee conducting "operations" at the end of the primary term?
- Reasons:
    - Drilling was not required by the terms of the lease. 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 has been the test, it would have failed*
    - **Test for "operations for or incidental to drilling":**
        - (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; and
        - (3) Preparatory steps must not simply be minimal
    - **Application to the facts**
        - Actual spudding in wasn't required because the habendum clause allowed for *operations* to extend the primary term
        - The activities taken by the lessee were with the good faith intention of drilling a well for production
        - The lessee was taking reasonable steps and showing expected dispatch as would be the norm in the industry
        - The steps taken were more than minimal (everything but spudding/drilling was completed)
    - **NOTE:** a harsh interpretation of the lease could have deemed the lease to be dead. This was a ***flexible approach*** as seen in *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, so the lease is valid and subsisting

- Drilling not required – preliminary acts were conducted with a bona fide intention to proceed with diligence to completion
- **Lessee:**
  - The general rule is that actual drilling is unnecessary, but that the location of wells, hauling timber, erecting derricks, water supply, and similar acts preliminary to the actual work of drilling, when performed with a *bona fide* intention to proceed with diligence towards completing the well, constitute commencement of the well or drilling operations within the meaning of this clause of the lease

- Ratio:
  - Lease set to expire may be valid and continue (despite precise terms of the contract not being fulfilled) if sufficient preparatory steps are taken to being operations (test)

NOTE: QUESTIONS TO ASK
1) What is the material date? What has to be completed for the lease to continue?
2) When analyzing have to look at the wording of the lease and the facts – was that enough to satisfy what was required?

***Canada-Cities Service Petroleum v Kininmonth* (1963 ABSC; 1964 SCC)**
Habendum clause trumps the continuous operations proviso (habendum as key clause in Canadian o/g law); production was needed to extend the lease past first term; operations can extend the lease but only if the lease had already been extended by production or delay rental payment

- Facts:
  - OilCo (lessee) obtained a 10-year lease from Kininmonth (lessor) on May 11, 1951 to drill an oil well. The lessee had to begin production before the end of the term
  - OilCo used its right to postpone from year to year its drilling requirement by paying delay rentals
  - OilCo drilled in March 1961 and found oil. At the time, ERCB had specified a special spacing unit for the area and OilCo's lease only covered the south half of the section – ERCB required them to cap their well and not produce
  - OilCo wanted to bring the producing well equipment on site but there was a road ban in effect, so the well did not produce until June 26, 1961
  - Caveat had been filed by the appellant to protect its interest under the lease
  - **Overall:**
    - Well was drilled in time but not brought to actual production until after the primary term expired
    - Lease included an operations clause in proviso 3 – "lease will exist for 10 years and so long thereafter as **production** has occurred)
    - No production at the end of the primary term, but operations
    - Proceedings brought to validate the caveat (which would expire in 60 days without action)
- Issue:
  - Although production had not occurred at the end of the primary term, could the 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 – lease had 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 strong; the operator could 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 was why they could not achieve production in the primary term
      - **Lessee has an expectation of prudence**
    - Focused decision on production/primary term with an expectation of diligence and dispatch
  - Dissent (MacDonald J):
    - Opportunity to extend based on continuous operations
      - 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 the lease
- Reasons:
  - NOTE: the habendum clause here is different than *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:** "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."
    - **Kininmonth fatal gap problem:**
        - Production required as a *condition precedent* prior to operations clause in a proviso taking effect ("at" vs "after")
            - Bishop vs Kininmonth lease language:
                - Bishop: "If at the end…" – allows for drilling/operations to continue the lease at critical juncture
                - Kininmonth: here the lease only contemplates sometime **after** the expiration of the primary term, doesn't allow for operations at the critical juncture
        - Lessee couldn't use any of the language of proviso 3 because they didn't qualify for the fundamental nature of the proviso – proviso said AFTER – this is strictly construed
        - Means that at the end of a primary term the ONLY thing that will allow the lease to continue is PRODUCTION, deemed or real
        - The proviso 3 here is meant to capture where during the secondary term there is a reason why the lessee has to take additional action to keep their production going (e.g. rework the well, drill deeper, etc.)
            - Not a continuous operations clause that would allow to persist with mere drilling
            - If you wanted proviso 3 to operate in this way you would have to **include "at"** – makes a big difference
            - Courts will not imply this language to the contract, so something as trivial as the absence of "at" to bridge the gap leads to the fatal problem that their lease is done
- **SCC:**
    - No production at the material time, and 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
    - The proviso 3 continuous operations clause here is designed to deal with the situation where the primary term has been extended by production and such production ceases outside the primary term
        - **This 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
- 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 died 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 the primary term to extend the lease trumps a continuous operations clause that states the lease will be extended if operations are paused for a reason outside the lessee's control (SCC says the proviso is not activated until production on the lease has in fact begun)

***Sohio Petroleum Co v Weyburn Security Co* (1971 SCC)**

Lease expired like in Kininmonth; arguing estoppel to keep lease valid requires more than mistaken belief and passive conduct – adds gloss to Kininmonth

- Facts:
    - Lease expires for the same reason as in *Kininmonth* – production is needed at the end of the habendum, didn't have deemed or real production
    - Parties use novel argument to try and sustain the lease – operation of **estoppel** – on four grounds:
        - (1) Weyburn (lessor) called Sohio to drill an offset well
        - (2) Sohio, at the request of Weyburn, paid a portion of mineral taxes
        - (3) Sohio paid and Weyburn accepted royalties
        - (4) Weyburn permitted Sohio to enter into a pooling agreement
- Issues:
    - Can an expired lease be subsequently enforced based on the words and conduct of the lessor?

- Can a party be estopped from denying validity because of words and representations?

- Reasons:
  - **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 promissory
    - **The lessor is NOT estopped from denying validity of the lease for the same reasons as in *Paddon-Hughes:***
      - (1) <u>No unequivocal representation by the lessor</u>
        - To assert your strict legal rights you need to know you have them. Here the lessor did not know they had the right to declare the lease invalid for some time
        - **Both parties were operating under the mistaken belief that the lease was still valid**
      - (2) <u>The lessee did not act on the lessor's representation</u>
        - Sohio was not relying on what they said to their detriment, but was relaying to their legal team. Didn't act on representations but on their own judgment
      - (3) **<u>Estoppel requires an existing legal relationship</u> and cannot revive a dead lease**
        - Representations were made long after the lease had expired
- Holding:
  - There were no grounds for estoppel to be relied upon by the lessee
- Ratio:
  - Estoppel by words and conduct cannot operate where both parties are under the mistaken belief that the lease was valid and continuing, and no representation was relied upon
  - Estoppel couldn't be used to revive a dead lease – SCC questions if it could ever work
  - If advising an o/g company you DON'T want to rely on estoppel

***Cull v Canadian Superior* (1972 SCC)**

Unique language in continuous operations clause extended the lease ("reasonable diligence and dispatch") because drilling was sufficient in the habendum

- Facts:
  - Lease expired on December 29. Canadian Superior completed the well on December 28. On December 28 they moved the drilling rig off the well site, brought in the service rig, and brought the well into production on January 7
  - There was a brief period with no drilling and no production
  - ***Cull* gap scenario: gap between the completion of drilling and production (but cured here by unique operations clause given purposive interpretation)**
    - Cl 12 (continuous operations clause): "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 <u>reasonable diligence and dispatch</u>, 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."
    - Habendum did not just say "produced" but also included "drilling, mining or reworking operations"
  - **Habendum language by itself couldn't continue the lease past its primary term with drilling but no production, but cl 12 is used to be a <u>modifier</u> to the habendum (adds additional gloss to what can propel the lease forwards)**
- Issue:
  - Is there a subsisting lease because of cl 12 or expiry because no production under the habendum?
- Reasons:
  - **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 after
    - It was a gas well and there was no available market at the time for gas produced from it – it wasn't intended to be put into production – no bona fide intention
  - 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 <u>lessee had the right to drill to completion with reasonable diligence and dispatch,</u> but <u>didn't say anything about necessarily bringing the well into "*production*"</u> 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***

        - Courts said we will allow this to count as production as long as the lessee takes reasonable and favourable steps to bring the well into production, in which case the production gap does not matter
        - So the lease is extended if you acted with reasonable diligence and dispatch to bring it 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 January 13th
    - **Key point:** this case turns on actual (*Cull*) versus deemed production (*Hambly*)
- Holding:
    - 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

Answer:

- Normal construction is strict
- Problem in *Kininmonth* is there was clear indications that the operations proviso only expired after the primary term. Leases can say "at" or "after" as an answer, and that then is still "strict" – it is giving meaning to the terms negotiated between them
- *Kininmonth* would say we aren't doing a broad/purposive interpretation to build in more flexibility because the words don't support it BUT other clauses CAN invite an interpretation of the habendum which is reasonable
    - Why we saw Ballem attempted to rectify
- If language doesn't try and change, it just tells you what can happen
- *Cull* was unique because it had a standalone operations clause that was read in view of the habendum that it referenced, so that particular lease invited a different interpretation because of the sort of language used – not what we normally see

***Canadian Superior Oil v Murdoch* (1969 ABQB)**

Shut in royalty deems production, but must have been paid before expiry of the primary term in order to extend the lease; gap with no production and no deemed production (no operations, production, or shut-in payment)

- Facts:
    - Mrs. M granted a 10-year lease to OilCo on April 22, 1950. 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 says to ERCB they want to shut in the well – granted in May 1960 and the lessee sends a SIR cheque to the lessor after. Actual production commenced after. 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 of the lease)
    - A year later another OilCo looks at the lease and determines that CSO did not have the required authorizations to get the lease because Mr. M had an interest in the land - CSO files a caveat – **CSO enters into an agreement that indicated the old lease was still alive and valid**
    - Mr. M makes a claim in 1961 that the entire original lease was invalid because at the end of the primary term there was no production
    - Trial:
        - TJ held that the lease was valid and subsisting on the basis of the agreement
        - Court construed the covenant as operating as an estoppel
    - Appeal:
        - The right that exists is contractual in nature, not necessary to look elsewhere to find reasons to uphold the lease
        - The agreement struck the settled the disputes between the parties, paid money as fresh consideration, and the OilCo gets ratification and confirmation that the lease was in good standing and in full force and effect
- Issue:
    - Deemed production did not result until May 16, 1960, which was after the expiration of the primary term – but is the lease still valid as a result of the second contract between the parties?
- Reasons:
    - The original lease was expired because there was no actual or deemed production as required by the habendum clause
    - But the lease was **extended by the contract** (a subsequent agreement) entered into by the parties
        - Agreed that the lease was valid in exchange for consideration
        - **Key point:** unlike in other cases, there was no intervening top lease
    - Lower courts decided this case on the basis of estoppel – but SCC says this is NOT an estoppel case
        - Mrs. M cannot get out of her lease because she contracted away her ability to do so
- Holding (Martland J):
    - The lease is valid and subsisting because of the agreement between the parties that the lease would continue. Valid consideration was provided

- Because there was an agreement between the parties, no reliance on promissory estoppel was necessary to resolve
  - Resolved as a contract – no mistake, no misrep, valid consideration
- Ratio:
  - A lease can be extended by deemed production, but this requires a shut-in royalty 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 cheque paid after
    - This means there was no production and no deemed production for a period of time
  - Parties can fix a defect in the lease (not through estoppel) through a normal contract
  - **Lease can be extended by contractual agreement between the parties after the lease expires**

Canadian Superior Oil v Paddon-Hughes **(1969 ABQB)**
Similar language to Cull; need actual or constructive production to extend lease term – there must be an existing relationship; if lease terminates, estoppel is not available; gap with no drilling operations or production/deemed production

- Facts:
  - A lease with a primary term of 10 years was entered into on June 17, 1948. Farm out agreement was executed on June 5, 1958. Farmee commences drilling on June 10, 1985. The well is finished on August 8, 1958. Apply to ERCB to shut the well in, and then send a royalty cheque on August 13.
  - OilCo was alive to *Kininmonth* problem and had attempted to amend the problem with the old continuous operations clauses by inserting clause 12: "if the lessee shall commence to drill a well within the terms 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 o/g found in paying quantities, this lease shall continue and be in force with like effects as if such well had been completed within the term of years herein mentioned"
    - Effectively: lessee shall commence drilling sometime during the term but shall have the right to complete the well outside the primary term using reasonable dispatch
  - On August 9, 1958 drilling production ceases, lessee suspends well and makes application to shut it in, makes SIR payment that is received on August 14, 1958
    - Note: **5-day gap where there is not drilling operations or production/deemed production** (between the time the well was completed on August 9 and the SIR payment on August 14)
  - 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
- Issues:
  - Is the lease alive at the time the well was finished? (no)
  - Is there a chance for an estoppel argument? (no)
- Reasons:
  - **Whether the drilling of the well and shut-in payments continue the lease**
    - 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 because the well was started
    - But – the <u>SIR was *not* made during the extended term, only *after* the drilling was completed</u>
      - Recall: ***Murdoch*** says that SIR must be made **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 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
        - Here there was no clear and unequivocal representation
        - Hambly did not know that he had the right to treat the petroleum and NG 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) Existence of a legal relationship between the parties when the representation is made
        - **Estoppel CAN'T revive a dead lease**
        - Estoppel can be passive or active

- Result: lessee is kicked off of the land – this case leaves open a blatant and indisputable unjust enrichment claim
- Holding:
  - Lease was not valid and subsisting because SIR payments were not received during the primary term; there was a gap where no production (actual or constructive) took place; estoppel argument fails
- Ratio:
  - Shut in payment must be received during the primary term (including temporary extension of term by a continuous operations clause) to continue a lease
  - If there is a gap between completion of drilling and deemed production by a shut-in payment, the lease is NOT continued

TO AVOID THIS SCENARIO:

- Make a **pre-emptive payment** in real time that negates the existence of a gap
  - Might even want to pay the SIR before the primary term expires if you're continuing with drilling after the date
- Hope that payment is accepted – should be sufficient to continue the lease forward
  - Could go badly if you make a payment that is **not accepted** – could still end up with a gap
- Overall: somewhat of a fiction, but the best course of action if you intend to drill to completion beyond the primary term then shut in and move forward with constructive production is to make the payment pre-emptively

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)
- Can be active or passive
  - E.g. in receipt of the necessary knowledge but don't say anything and allow a relationship to occur or continue
- NOT available as a cause of action and requires an existing legal relationship when action/event in question occurs
- Estoppel CANNOT REVIVE a dead lease (Martland J in ***Hambly***)
  - Not saying it couldn't operate in unique circumstances, but we have essentially seen courts rule it out
- Best course of action where the lease looks frail = create a new contract/remedy the contract for consideration (*Murdoch*)

Fatal Gap Problem/*Kininmonth* Problem – Summary

1. ***Kininmonth:*** production required a condition precedent prior to operations clause becoming effective ("at" vs "after")
2. ***Cull:*** gap between completion of drilling and achieving production
   a. Cured here by unique cl. 12
   b. Purposive interpretation (not the norm, usually we see strict interpretation but here was justified on the basis of unique language)
3. ***Murdoch:*** gap in shut-in royalty payment
   a. Not cured by clause, but instead cured by a subsequent contract – really the only way to achieve this
   b. As per *Hambly,* to take advantage of a SIR it must be paid before the primary term expiry

***Republic Resources Ltd and Joffre Oils Ltd v Ballem* (1982 ABQB)**

Gap between primary term and production – lease terminated; no estoppel by silence, even in the case of a sophisticated representor

- Facts:
  - A gap existed where there was no actual or deemed production for several days. The lease itself concluded on August 7, 1973 with a 5-year primary term. The company commenced drilling one week before the expiry of the primary term. It did not achieve production of gas until September 1, 1973 (after the expiration of the primary term)
  - There was an attempt to deal with the *Kininmonth* problem in a proviso to the habendum:
    - "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 *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*, then this lease shall remain in force so long as such operations are *continuously* prosecuted and, if they result in the production of the leased substances or any of them are produced from the said lands."
    - **Remember:** proviso must be read in light of the habendum and; if production is needed it can be deemed or real
  - Further problem that the parties included an option for lease renewal open for 30 days past the primary term expiry
    - Application was complicated because Ballem waited until *after* the option for renewal expired to notify of lease invalidity

- Issues:
    - Is the lessor obliged to inform within option period?
    - Is there anything in the lease instrument that that the lessee can avail itself of for the lease to survive?
- Reasons:
    - **First argument: attempt to deal with it under the proviso of the habendum**
        - Court expressly acknowledges that this language was included to try to deal with the gap scenario, but the language does not cure the gap
        - It was not enough to cure the gap – to achieve the result necessary for the lease to survive, the word "after" should be deemed to mean "at"
        - Court refuses to **revise** the language (more than just giving a broad interpretation) – if they wanted the word "at", they should have used it
    - **Second: renewal clause – no obligation to notify**
        - Says there is a 30-day window at the end of the primary term that the lessee can use to renew the lease for 10 years (not a perpetual renewal)
        - Problem: there was no exercise of the option to renew until the 30-day period had passed
            - Court looks at whether the lessor had an obligation to inform the lessee that their position was that the lease was not valid, which would raise the issue for the lessee and let them trigger the renewal – decided there was no obligation to notify
            - The option is held for the benefit of the lessee, no obligation on the lessor to notify, no misrepresentations were made
        - NO DUTY to disclose to the other party things relevant to their legal position
    - **Third: no estoppel by silence**
        - No positive words and representations were made, but rather knowledge of a defect by one party which allows the other party to expend money, etc., without asserting their legal right
        - This argument fails on the last test of estoppel (encourages plaintiff's expenditure of money in other actions or by not asserting legal right)
    - **Remedy: no unjust enrichment**
        - 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
        - Other:
            - **Unofficious trespasser (no bad faith):** satisfied – mistaken belief
                - OilCo mistakenly let the lease expire and did not blatantly exploit the Ballem's rights
            - **Incontrovertible benefit:** not satisfied
                - No free acceptance as in *Weyburn* where the lessor had knowledge of the ongoing operations and accepted royalties
                - In this case there is an unascertained benefit conferred on the defendant
                - There is no authority for the court to impose a lien/charge against future net proceeds of production to offset the costs of the well
                - The OilCo took a calculated risk by starting drilling late into the lease – Ballem had yet to benefit/hadn't received the full proceeds of production
- Holding:
    - Ballem receives a fully functional gas well and the OilCo is kicked off the land
    - Lease expired at the end of the primary term; lessors were not under an obligation to inform the lessee of invalidity
- Ratio:
    - Where parties used "after" but could have used "after or at" in the lease (would have cured the gap), courts unlikely to read that language in
    - Estoppel and unjust enrichment hard for lessee to make out – silence is not sufficient

3. **PRODUCTION**

Basic Habendum & 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 them are produced"
- **Common proviso language & lease lifecycle**
  - "If at any time during such term and after the discovery of production of said lands and if the production shall cease and all wells shall be abandoned, then this lease shall terminate on the next anniversary date"
- **Canada lacks a clear CL definition of "production"**
  - Cases turn on a lease-by-lease analysis
  - If it is defined, we can just look to the lease
- "Commercial production" is commonly defined
  - Recall offset well scenario (trigger drilling on neighboring land)
- In the event that the lease fails to define production, then the court may look to "commercial" production for guidance
  - If no – could look to American jurisprudence – *reasonable operator test (**Clifton v Koontz**)*

Clifton v Koontz **(1959 US Texas SC)**

Production test

- Facts:
  - Marginal gas well that was operating at a slim profit. Evidence indicated that the well alternated between being profitable for years and not being profitable for months. Overall, it was producing at "paying quantities" since profit exceeded operating and marketing costs
- Reasons:
  - **PRODUCTION TEST:** would a reasonably prudent operator, for the purpose of making a profit and not merely for speculation, continue to operate the well in the said manner?
    - If yes = production
    - If no = production fails
  - Note: variety of factors that can make a well profitable (e.g. market conditions, depressed price for extended period of time)
    - Court has to use its **discretion** in assuming or investigating what a reasonable operator would do – this is why the test was developed
    - Production **cannot** simply be going to the well and showing just a drip of substance – not production because a company would not operate that for the purposes of turning a profit

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 ended January 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 drilled two new wells and put them into production until their licenses were revoked – then appealed the decision of the ERCB to suspend the two gas well licenses because the underlying lease had expired
    - Omers sought to rely on the suspended well clause in the lease to extend the terms
    - The clause continues a lease as though operations were being conducted, providing the well was "capable of producing the leased substances" and shut in
  - Basically: Argument that the wells suspended were not capable of producing lease substances, Board said it can't just be "some substances", has to be meaningful production in the present state and configuration of the wells in question. Omers tried to rely on the suspended wells clause to allow it to continue in the absence of production
- Issue:
  - What level of production is required for the initial lease to remain valid and subsisting?
- Reasons:
  - **Standard contractual interpretation**
    - 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
    - Test was an objective standard: what a reasonable person would infer from the words used by the parties
    - Habendum clause:

- Lessee has 5 years to commence operations. Once the 5-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:
        - 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) must commence with no cessation of more than 90 days between successive operations
    - Bad drafting – if capable of producing, it will continue (generous to lessee)
- **Capable of producing**
    - Requires:
        - **(1)** The capability to produce (in its existing configuration and state of completion); AND
            - Means you turn on the valve and the well is producing
        - **(2)** The capability to produce *meaningful quantities* of the resource (has to have some sort of volumetric language)
            - Meaningful: quantity that is sufficient to provide a reasonable expectation of profits
            - Similar (but not the same) as the meaning of producing in a "paying quantity" used in the US
            - **Test: would an objectively reasonable operator, acting prudently and for the purposes of making a profit, continue to operate the well in the same manner?**
    - The water logging problem faced by Omers meant that the well was not capable of meaningful production in its current configuration or state of completion
        - Differentiated from ***Bearspaw*** where the well was capable of immediately transporting NG but there was no pipeline available for transport
        - It was never intended that the shut-in well clause could allow a lessee to hold a property for purely speculative purposes
- ***Clifton v Koontz* test adopted**
    - American "paying quantities" test (*Clifton*) – does this require a moment-by-moment accounting?
        - Court did not endorse this test and did not say there needs to be this kind of accounting
        - Board gave reasonable interpretation to key language in dispute
    - The parties did not include "in paying quantities" in clause 3 – this phrase should not be implied

- Holding:
    - Lease no longer viable. The well was not ready and able to produce gas in the required quantity when the tap was turned on
- Ratio:
    - Capable of producing means: (1) the capability to produce in its existing configuration and state of completion, and (2) the capability to produce meaningful quantities of the resource (some volume of NG sufficient to provide a reasonable expectation of profits)
    - These conditions must be fulfilled for there to be a valid shut-in
    - Cannot just shut in a well for speculative purposes; must be a shut in of a well that could be productive

***Bearspaw Petroleum Ltd v Encana Corp* (2011 ABCA)**

Extension of lease through clause that allows for extension if well is "producible"; ability to produce a 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 Corp from a declaration that the respondent, Bearspaw Petroleum, had a valid and continuing PNG lease
    - Unique habendum language: lease will continue "so long as the leased substances or any of them are **producible** from the leased area" (producibility sufficient to continue)
    - Enbridge argument:
        - Producible means to be capable, without more, of immediately being put into production in commercial quantities
    - Bearspaw argument:
        - Producible 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)

- Issues:
    - What is meant by "producible"?
    - If 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?
- Reasons:
    - **Producible means something capable of being produced or brought forward**
        - Producible, unlike production, contemplates a *future occurrence* – something less than immediate production is appropriate
        - Something can be producible that is not being produced today
        - Subsequent steps of tying in a completed well satisfies this
        - **Why?** The requirement that a pipeline exist for every completed NG operator to maintain their lease would <u>not be commercially viable</u>
            - 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 commercially unfeasible
    - **There is no implied covenant to market**
        - Asks if there is a timeline that parties have to follow to take additional steps – no
        - Clause 4 answers this – language does not impose a timeline on the lessee for tying in the completed well
            - Instead it gives some discretion to the lessee who is able to move forward with orderly development of the substances having in mind geological efficiency of development considerations, looking at market consideration
        - No evidence of bath faith – just figuring out the best way to move forward with the completed wells
            - This is the kind of discretionary action permissible under the lease
            - Shows why we don't end up with clear jurisprudence – end up with unique language that brings analysis into these niche areas as opposed to considering the term expressly
- Holding:
    - Bearspaw's lease is valid and subsisting
- Ratio:
    - 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. pipeline)

QUESTIONS:

- **What is required under normal circumstances to maintain and o/g well?**
    - Q: When does production end during secondary term if a lease naturally comes to its conclusion?
    - A: When the amount/volume of substance coming out of the well has reached a level that a reasonable operator would no longer maintain operations for the purpose of profitability – at this point production will have run its course
- **Is advising a lessee, what guidance would you give about the lease?**
    - Use interpretation section of the lease to describe what they want the term "production" to mean
    - Can set a rate of production as the minimum that will be accepted as producing under the well – open to the parties to set down what they think the right level of production should be
    - This level of detail is highly recommended

4. THE SHUT-IN WELL CLAUSE

<u>Overview</u>

- Permits the lessee to shut-in a well, stopping **actual** production, but maintaining the lease through **deemed/constructive** production (ultimate goal being the lease continues to be valid)
    - Deemed production requires timely payment by the anniversary date
    - Usually want to make an advanced payment so there is 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 will not
- Highly situation-dependent, but often includes:
    - 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
        - This is true even in a case brought by the lessor, where the overall burden rests with them – burden still on lessee to justify shut-in
    - The onus is always on the lessee who wants to prove they will fall within the proviso to excuse non-actual production (i.e. that the well is shut-in for one of the three above reasons)
- Discretion:
    - Some leases are so broad they give the lessee **full discretion** to shut in for any reason they deem appropriate
    - This is a bad idea for the lessor – only want a shut-in to occur in a limited set of circumstances (then only entitled to a shut-in well payment)
- **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 three valid reasons included in the SIR clause, but they are really doing so for their own convenience and the court denied them the use of the shut-in well clause
        - ***Durish:*** claimed their actions fell within "good oilfield practice"
        - ***Teg:*** claimed shut-in well due to "lack of market and transportation facilities"
        - ***Freyberg:*** claimed there was "no available market"
    - **Clash of interests:** lessee will prefer broadly worded shut-in well clauses

Kissinger Petroleum Ltd v Keith McLean Oil **(1984 ABCA)**
SIR made in advance and in contemplation of a shut-in 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 that the cheque was a shut-in royalty payment. They finished operations and shut in the well. 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)
- Reasons:
    - 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 SIR and there was a 5-day gap between the operations and production (note – *Hambly* dealt with deemed production)
        - Court has said that it is appropriate to pay the SIR at the time they secede they will shut-in the well upon finalizing operations
    - In contrast, in ***Cull*** the lease was extended so long as the well was brought into production within reasonable diligence and dispatch (dealt with actual production)
    - Court should adopt a construction which results in a reasonable result rather than unreasonable
    - **Key point:** points to the difficulty of getting deemed production
        - Lessee was proactive and sent the SIR cheque before they actually shut 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 (courts haven't ruled on this question yet)
- Holding:
    - Lease continued
- Ratio:
    - A SIR payment made in advance and in contemplation of a shut-in well before operations of completing the well have been completed is an adequate way of ensuring there is no gap between operations and production, or production and deemed production
    - Acceptable to pay the SIR at the time that the lessee decides not to produce upon contemplation of the well
    - Payments must be clearly marked as such – have to clearly show that the payment is a shut-in payment

Trio of Failed Shut-Ins

***Durish v White Resource Management Ltd* (1987 ABQB)**

Good oilfield practice is situational but cannot be subject to the arbitrary whim of an operator; failure to come to a timely resolution of another dispute is not valid

- Facts:
  - Durish was the assigned lessor and W was the lessee for a well that went into production. Producer had a dispute with another party over costs of transporting the gas, so the well was shut-in as a result of the dispute
  - Because the lease was extended by production beyond the primary term, W (the lessee) argued that the terms of the habendum relating to non-production for any cause whatsoever in accordance with "good oilfield practice" applies to this dispute, and that the lease is therefore valid in subsisting
  - In the alternative, W argues that they have paid the SIR (but paid late)
  - In further alternative, W argues that they were entitled to notice of breach of the contract
- Issues:
  - Does Gulf's shutting in of the well as a result of W's non-payment of fees trigger "good oilfield practice" such that the lease is valid and subsisting? (no)
  - Is the payment of SIR's 7 months after production ceased a reasonable period of time? (no)
  - Is the payment of SIR an obligation under the lease such that W was entitled to notice of breach? (no)
- Reasons:
  - **Option 1 - Proviso 3**
    - If there is a break in production the third proviso usually gives the lessee 90 consecutive days to get production going again (grace period)
    - If 90-day clock expires then you have termination
    - This clause operates to stop the clock – 90 days doesn't run
    - BUT must be in accordance with <u>good oilfield practices</u>
  - **Option 2 – Standalone shut-in well clause**
    - This is *option* not an obligation
    - At end of the year with secondary term, if there has not been production, lessee can pay to continue into next year to deem actual production and carry you over
    - What is the obvious concern? That there are no limitations (but overall limitation is timely payment)
      - Lessor can shut-in, make a timely payment, and keep it going
      - This language is hugely disadvantageous for lessor
      - Should impose conditions for when a shut-in can happen
    - Is this clause subject to a proviso 3? Some language indicates yes
      - ***Kensington*** says no – independent provisions, language that says "subject to provisions hereinbefore" is not enough to make one provision operate to effect another
      - A shut-in under proviso 3 serves a <u>different purpose than a shut-in well clause</u>
        - Meant to deal with disruptions, vs scenarios where there has been non-production for more than 90 days and the lessee exercises an option to continue the well
  - **(1) Does shutting in the well over a dispute over fees fall within the ambit of "good oilfield practice"?**
    - No - a contractual dispute was not a sufficient reason to shut in the well. Since the shut in was invalid and the production ceased for more than 90 days, the lease expired
  - **(2) Was late payment sufficient to extend the lease?**
    - No - the lease indicated that if there was no production (for 90+ days) then the SIR must be paid <u>"at the expiration of the year"</u>
      - Court interpreted this to mean payment on the anniversary date or within a reasonable time before or after such anniversary date
      - Payment not made for 7 months – not timely (usually strictly construed)
  - **(3) Lessee entitled to notice of default?**
    - No – payment of SIR is NOT an obligation – it is an option/privilege open to the lessee to continue the life of the lease if he chooses
    - Here if the lessee fails to pay the SIR, there is no requirement that the lessor inform him since there is no breach
- Holding:
  - Not good oilfield practice, payment not received in time, lessee not entitled to a notice of breach
- Ratio:
  - Payment of SIR is NOT an obligation – it is an option so the lessor does not need to give notice to lessee when it is not received
  - Good oilfield practice for shutting-in does not include a dispute over payment between lessee or the operator farm out to

NOTE: the court softened the payment provision of the SIR, holding that payment can be made within a "reasonable time either before or such anniversary date"

- Did this 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
- Again – seeing more liberalization of Martland J times of strict construction (***Cull, Crozet, Durish***)

***549767 Alberta Ltd v Teg Holdings Ltd* (1997 ABQB)**

Lessee failed to show that shut-in for 20 years was defendable on the basis of lack of market and transportation facilities; strong onus on lessee to prove

- Facts:
  - Lessors (numbered co) had two leases with Chevron – C reserved a 15% overriding royalty in both leases and assigned the rest of its interest to Telstar. Then Teg acquired C's overriding royalty interest
  - Telstar was the operator of the lease from 1976-1994. Then T quit and claimed its entire interest under each of the leases to Teg
  - For 20 years the well remained shut on the alleged basis that there was no available transportation or market for the gas
  - Lessor now claims the leases have expired for lack of production
- Issue:
  - Was there a valid shut-in owing to a lack of transportation or lack of market?
- Reasons:
  - The **onus** is <u>always on the OilCo who wants to shut-in, to prove that they fall within the proviso to excuse non-production</u>
  - **Transportation:**
    - The nearest pipeline was only 3 miles away from the wells and would have had capacity for the lessee's gas
    - They could have negotiated with the carrier or applied for a common carrier order
  - **Lack of market:**
    - At some point during the 20 years the market for gas was good, and sometimes great
      - Real problem – transportation was costly, not impossible
    - Sufficient evidence: could be indicia or market, transportation, expert and non-expert evidence
  - Overall: did not fulfill any requirements under the SIR clause
- Holding:
  - Shut in fails. Lessee could have applied to the ERCB for an order to declare a pipeline a common carrier. A market was available
- Ratio:
  - Lessee has a <u>fairly strong onus</u> 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 favourable to their own interests (for reasons outside of general market conditions)

***Freyberg v Fletcher Challenge Oil & Gas* (2005 ABCA)**

Identical clause to Teg; test to determine an economic and profitable market – based on info available, would a prudent lessee have foreseen profitability

- Facts:
  - Lady F owned 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 20+ years, citing a lack of market
  - When the well was finally put to production in 1999 the well-head had a high level of production in the field. The lessee claimed there was no economical or profitable market
  - But the lessee had another well in the field with a greater interest – so the lessee could increase their return by increasing production from one of the wells and drain the pool
  - F argues that the extended length of shut-in was not justified based on the evidence, and wants a declaration that the lease had terminated
- Issues:
  - Did the lease terminate in the secondary term for lack of actual or deemed production?
  - Does the lessee have to give notice of default?
  - When/how do we assess the existence of a profitable market?
- Reasons:
  - Trial court:
    - Court found there was a justification for the lease being terminated, but there could be a remedy simply by damages
    - Wanted to cure the defect that had occurred under the lease
    - CA dismisses this reasoning completely

- **Strict construction of the shut-in clause was appropriate because of 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, damage)
  - Risk that the substance will be captured by other wells
    - Reservoir can be drained from neighboring wells
  - Note: different interests of operator and lessor
    - Probably attempted to avoid development because they were getting better returns on other plots of land
- **Did the lease terminate during the secondary term?**
  - The fourth proviso simply extends the lease when a well drilled within the initial term is shut-in due to an intermitted, 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 of the lease, there is no deemed production and the lease terminates</u>
- **Was there an economic and profitable market prior to 1999?**
  - Onus: on the lessee to show there was valid deemed production to extend the lease
    - Must show that an economical and profitable market did <u>not</u> exist so the well can be shut in and production deemed, allowing the lease to be extended
  - What evidence to look at:
    - Can look to expert evidence and other factors like productivity of surrounding wells
    - Here: overwhelming evidence that there was a profitable market
- **<u>Objective test for determining whether there is a "profitable market"</u>**
  - ***Would a prudent lessee based on the information they had available at the time have foreseen profitability?***
  - This is an **objective standard** because 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 expectation of the parties

- Holding:
  - Lease expired because the facts were insufficient to show unavailable market that would support not producing from the well
- Ratio:
  - Objective test for determining whether there is a profitable market
  - Onus on the lessee to show the shut-in is justified on the terms of the lease
  - Strict construction of SIR payment clauses
  - Note: this principle is similar to *Durish* (dispute over costs) and *Teg* (overencumbered) because the lessee is shutting in the well for their own convenience and not for the reasons included in the clause

***Kensington Energy Ltd v B&G Energy Ltd* (2008 ABCA)**

Purpose of SIR clause in this case was to prevent 90-day limit from running against lessee if during the secondary term the well was shut in for good oilfield practice; look to entirety of agreement to determine intentions

- Facts:
  - The well was a supposed dry well that was shut-in by K, B was the top lessee challenging the validity of the lease. The clause read that a shut-in was "subject to" good oilfield practice. The question is whether this subject limited the circumstances that would allow for the shut-in of the well
  - Note: lease language almost identical to ***Durish*** (third proviso allows a shut-in in accordance with GOP, allows for payment to extend the lease into the next year)
- Issue:
  - How to properly reconcile proviso 3 with the shut-in well clause
  - Did the shut-in clause allow the shut-in in this scenario?
  - Did the TJ err in concluding that the shut-in well clause could only continue the lease if the shut-in occurs in accordance with "good oil field practices" as per proviso 3?

- Reasons:
    - How to interpret:
        - 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 (clause 3):**
        - Sets out circumstances under which a shut-in payment must be made
        - Specifies that the amount of shut-in payment is equal to the delay rental
        - Deems the shut-in well to be a producing well according to the habendum
    - **Two applications of proviso 3 to 'stop the clock'**
        - At or after the expiry of the primary term
        - It is a standalone function
    - **Four reasons to not limit the shut-in clause with good oilfield practices requirement (to not link proviso 3 with cl 3)**
        - Because:
            - Proviso 3 is about stopping the clock only in limited circumstances
            - Shut-in well allows for shut in only in discrete circumstances (duration more than 90 days)
            - Proviso 3 stated that the excuse of good oilfield practice for shut-in only applied to 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
        - If we want them linked this needs to be expressly stated
        - Need to be careful when drafting leases (especially lessor) because we don't want to leave the lessee with broad discretion as to when to exercise the option to shut in
    - Habendum:
        - Provides that the lease will stay in force so long as the leased substances are produced
        - Cl 3 states that if the delay rentals are paid then the well is deemed to be a producing well
        - Here all the delay rentals were paid and the lease remained in force by reason of deemed production
    - Proviso 3:
        - This is a **distinct provision that does not limit the actual shut-in clause** (does not add a limitation)
            - The allowance of a 90-day period of no operations simply allows the lessee to suspend production for 90 days when no valid excuses are present; beyond this, the shut-in royalties must be paid
- Holding:
    - Lease is valid and continuing because shut-in payments have been paid
    - Clauses of the lease must be read separately so it did not matter whether Kensington had an excuse of circumstances beyond their control or GOP – those excuses only necessary where there are no operations for longer than 90 days AND no SIR payments made
- Ratio:
    - If the lease allows for payment of shut-in well payments that deem production to have occurred, then the lease will continue so long as those payments are made

5. OPERATIONS UNDER AN INVALID LEASE

Overview

- Question: what do we do when the lease was invalid, but the lessee kept working the land? What do we do with the profits?
- Courts struggle with determining what is *just and equitable* in this situation
    - Important phrase
    - ***Sohio:*** SCC endorses the appellate court's reasoning on remedy, uses this language of "just and equitable"
    - Guiding idea for the courts but has not led to consistent results
- **Common problem:**
    - Existence of a productive well suggests that the proceeds of production should have gone to the lessor
    - Why? They are her minerals, she has the reversionary interest
    - Note: unjust enrichment largely operates in the background, not a main principle
- **Conversely:**
    - If the lessee is simply excluded from the land, they may be leaving behind a fully functional o/g well that they invested heavily in
    - Many sunk costs – human, mechanical, labour

Damage awards

Damage awards based on actions framed in:

- **Unjust enrichment** (early cases)
  - Argues by the lessee
  - Operates similarly to estoppel in previous sections – where one party is forcing another party to deny lease validity
- **Breach of contract** (always available)
  - Argued by the lessor
- **Trespass** (***Sohio; Stewart Estate; Montreal Trust***) or **Conversion** (***Stewart Estate; Freyberg***) (available since 2004)
  - Argued by lessor
  - Both actions are possible (*Stewart Estate*), but trespass is more likely
  - Trespass appears more aligned with Canadian law and the view that minerals are not under complete ownership until they are reduced to personal property when there is actual possession (prior to this point only an exclusive right to work)

Damage awards that seek to:

- **Disgorge** (fully or partially) – restitution gains-based rationale; or
  - Disgorging lessee from profits
  - Restitution: about ill-gotten gains – what did the party benefit from their illegal action?
- **Compensate** – tortious compensatory rationale
  - Compensating the lessor
  - Compensatory: focuses on the defendant's loss
- The choice that is made will impact the damage award that is granted

Champlain Refining Co v Aladdin Petro Corp **(Okla Sup Ct 1951)**
Lessee as a good faith trespasser must account for profit but deduct costs 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:
  - Oklahoma issued licenses and leases to Champlain in error – land was actually privately owned. Champlain works the land erroneously and ends up developing and marketing some substances actually owned by Petro Corp.
  - This action based primarily in conversion
  - Champlain agreed they didn't have a proper legal right and voluntarily paid the proceeds from development, but wanted to subtract out of this cost the costs associated with developing (costs of production)
- Trial:
  - Champlain required to forfeit the proceeds they agreed to pay as well as additional proceeds
  - Based on the highest market value for the substances at the time of wrongful conduct by Champlain
    - Principle of conversion: if the substance/product that has been converted has a fluctuating value, the court can order that the monetary replacement be set at the *highest* value
- Issues:
  - Is Petro Crop entitled to the *highest market value* in conversion? (no, they waited too long)
  - Is Champlain entitled to offset the claim with reasonable costs of production? (yes, otherwise would be UJE)
- Reasons:
  - **Conversion claim:**
    - It is a principle of conversion that a plaintiff may recover the highest value of the converted property when the converted asset has a fluctuating value
      - **Caveat:** to take advantage of this, must commence and prosecute the action with *reasonable diligence*
    - Not entitled to highest market value here because the plaintiff failed to exercise reasonable diligence in prosecuting their action
      - This extraordinary remedy demands promptness – here there was a 15-month delay
      - Champlain acted in good faith (was willing to take prompt action on its own behalf to rectify the situation, truly thought they owned the land, paid money for the lease)
  - **Damages:**
    - Court assesses damages as the marketed value subtracting out reasonable costs of production, including the non-productive diagonal well, drilled in good faith
  - **Unjust enrichment**
    - Somewhat subconscious application of UJE:

        - (1) Unofficious trespass: defendant an unofficious trespasser - innocent, thought they had a right to produce
        - (2) Incontrovertible benefit: plaintiff received an incontrovertible benefit – plaintiff is an oilco 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 wellhead/equipment)**
        - UJE operates to fill a gap when there is no contractual solution
        - UJE 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 of the benefits of the resource worked by the lessee
- Holding:
    - Payment of net revenues ordered, but not at highest market value (based on market value of oil when brought to the surface)
    - Champlain 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 conversion) *if* they prosecute with reasonable diligence
    - When determining whether to set damages at the net proceeds or gross proceeds, net proceeds will be awarded if the trespasser did so in good faith

NOTE: conversion is an unlikely remedy for o/g in the ground in Canada
- Why? Different recognition of o/g in situ (which we have) vs recognition of possessory interest in the o/g under your land (which we do not have)
- Remember: in situ ownership exists as a bundle of rights; oil and gas not personal property until reduced to actual possession at the surface
    - Trespass is first – it leads to the conversion
    - After trespass the substances are reduced to physical possession and marketed
- In the Canadian context probably more easily squared with *trespass*

<u>Historical and Contemporary Issues</u>
- 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. error in transactions, in title description
    - **(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
        - More common
- From 2004 onwards, the trend seemed to focus less on unjust enrichment and more on simple torts damages for trespass, as informed by equity
- ***Stewart Estate* (2015 ABCA):** makes it clear that trespass/conversion are applicable to mines and minerals cases
    - On exam note both are thus available
- BUT this <u>does not mean there is certainty in the application of mechanism for setting damages</u> – court still struggles with this

***Sohio Petroleum Co v Weyburn Security* (1971 SCC)**
First CDN case; court was guided by equity – only had to account for benefits realized through production once they were made aware of their mistake
- Facts:
    - Basically a *Kininmonth* problem – construction on the well started during the primary term, well was completed outside of the primary term, and was therefore invalid because the lease required production at the termination date to extend the lease
    - Problem = well was very successful and produced for 12 years
- Issue:
    - What damages are warranted? What to do with the period of production and money gained during this time?
- Reasons:
    - **Lease termination + lessor *not* estopped from denying lease validity**
    - SCC doesn't spend much time addressing the approach to damages, deals with it in an unjust enrichment frame
        - Looks at what should be the equitable outcome

- **Approach**
  - Court selected a moment in time (here, the moment the writ of summons was served) that roughly approximated when the money the lessee made from production exceeded the capital costs that were expected to achieve production
    - Lessor ends up receiving 30% of net proceeds
  - Lessee required to account for capital cost expenditures, lessor gets the net proceeds from the rest
  - Damage award framed in **restitutionary language**
  - Uncomfortable precedent because it used a moment in time and NOT a quantifiable algorithm – *completely factually dependent*

- Holding:
  - Trespasser entitled to keep profits up until the statement of claim was served
  - Up until the statement of claim was filed because until then they weren't making profit – once they made a profit the court felt it was fair to give to the true owner
- Ratio:
  - Decision completely fact-dependent, but first Canadian case to deal with this
  - Sets a tough precedent moving forwards
  - Begins quest for "just and equitable" remedy

Montreal Trust Co v Williston Wildcatters **(2004 SKCA)**

Court identified two modes of restitution (harsh and mild); said mild was appropriate; not binding in AB just persuasive; transition from unjust enrichment and restitutionary approaches to shift to compensatory awards

- Facts:
  - Wildcatters produced oil for 10 years on lands owned by Montreal Trust without a proper lease in place. Court does not award the net proceeds of production because Montreal had no intentions of setting out and drilling/producing from a well on the land. The **lacked the legal ability** (as they held the land in trust for the true owners) and practical ability
  - The lease at the end of the primary term was allowed to continue as long as there was production, or the lessee was continuing drilling/operations
  - Ends up being 10 years of production under new productive well when the lease had actually terminated
  - Trial: TJ awards lessor a royalty + bonus
- Issue:
  - How should damages be assessed?
- Reasons:
  - **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 loss to the plaintiff**
    - This is often used if the defendant has not caused any physical damage to the plaintiff, but had still wrongfully profited from his trespass
    - These may also be conferred in cases of mistake
    - In this case, the defendant mistakenly believed that they were authorized to develop the substances
  - **Trespass/conversion rules for damages:**
    - **(1) The "harsh" rule (full disgorgement)**
      - Not allowing a deduction of damages for production costs (damages based on gross proceeds)
      - Look to the value of the substance that was won and subtract out only the cost of transporting the substance to market and NOT the cost of putting it in a marketable state
      - This is used where the defendant *knew* they were committing a wrong – focuses mostly on the nature of the defendant
      - Here, to order the lessee to pay damages in the amount requested would result in a large windfall profit to the appellant
    - **(2) The "mild" rule**
      - Where the trespass is not tainted by fraud or bad faith, the punitive element is removed
      - Two variations:
        - **1) Partial disgorgement (restitutionary) – the "mild" approach**
          - Used where an innocent trespass has occurred
          - Damages are the market value minus all reasonable costs
          - More in alignment with *Sohio* where the court wants the defendant to break even without overly benefitting
        - **2) Royalty (compensatory) – the "milder" approach**
          - Operates more in scenarios where the plaintiff could not have put the material in a marketable state themselves

        - The best evidence of loss is the royalty payment that the plaintiff would have received from a new lease
        - Instead of focusing on the defendant, focus instead on what the plaintiff could have reasonably expected
        - This is what applied in this case – the plaintiff is entitled to the amount they would have made from a royalty, with costs deduced
            - This is a bank and not an oilco – 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 maybe the gross proceeds
        - The claimant would have been compensated but the overcompensation would be justified as a result of the wrongdoing
- Holding:
    - The lessor received damages in the amount of a predicted bonus and higher royalty payment that they would have received from another lessee during that period
    - Court focused on the fact that the plaintiff did not have the ability to produce oil themselves
- Ratio:
    - The "harsh" rule will be used to calculate damages if the trespasser knew it was committing a wrong
    - The "mild" rule will be used if the trespasser was innocent
    - The milder rule seeks to return the aggrieved party to the state they would have been in had the trespass not occurred

NOTE: usually not totally clear on what is being included and what is not being included

- Usually with disgorgement, NOT talking about the initial costs of drilling the well because this is an expense the lessee would incur anyways
- More interested in costs associated with maintaining and working the well, severance and getting it to market
- It would be very rare for the defendant co to be required to have removed from this all of the capital expenditure that goes into the initial infrastructure development

<u>Progression of English Cases</u>

- ***Martin v Porter:*** wilful trespass + coal extraction
    - Applied "harsh" rule with deduction only for the cost of transporting coal to the mouth of the mine pit
    - Very minimal transportation costs
- ***Wood v Morewood:*** mistaken belief + coal extraction (not wilful trespass)
    - Applied "mild rule" in partial disgorgement without lessee profit (market value minus the cost of mining and carrying to the surface)
    - Not about punishment, but about preventing gains
- **Both the harsh and mild approaches are flexible:**
    - ***Morgan v Powell:*** outrageous conduct
        - No transport deduction in application of "harsh" rule from *Martin* – very punitive
    - ***Livingstone:*** landowner only received royalty – don't want plaintiff to benefit
        - Focused on landowner, used milder rule
- **Where does *Sohio* fit in?**
    - Likely in the "mild" approach – but in using "just and equitable" it opens the door for courts to use the harsh or milder approach
    - It is all available, which is why *Sohio* is an uncomfortable precedent
- **English jurisprudence worked its way into Canadian natural resource extraction disputes in *Shewish v MacMillan Bloedel Ltd***
    - Parties agreed that ***Sohio*** governed resolution of the dispute
    - But does this mean that:
        - Restitutionary damages *must* be awarded?
            - No – they don't always have to be awarded
        - That the *operative date* is the moment in time that the lessee is made aware that the lease may be invalid?
            - No – just the approach the court in this case felt appropriate – focus on "just and equitable", what makes sense for the parties
            - All three forms available
        - Did not expressly endorse any "harsh" or "mild" approach

        - Analysis guided by the "just and equitable result"

- **<u>Proper approach</u>**
    - *Need to look to the facts and apply the law, as appropriate, within the "harsh" and "mild" framework*
    - Here:
        - **(1) Harsh**
            - To deter wilful trespass
            - Full disgorgement of proceeds (minus transport costs, probably)
            - Restitution-based approach
        - **(2) Mild #1**
            - Punitive element removed and the trespasser "breaks even"
            - Plaintiff received what they would have had they extracted and sold the resource
            - Restitution-based approach
        - **(3) Milder #2 – royalty**
            - When the plaintiff could not work the product themselves, they will not get a "bump" - focus on plaintiff
            - Royalty only
            - Compensatory approach

***Freyberg v Fletcher Challenge* (2007 ABQB)**
Applied Wildcatters and awarded the mild form

- Facts: above
- Reasons:
    - Application of the same approach as in ***Montreal Trust Co***
    - **Damages**
        - Compensatory approach – royalty + bonus
        - Found conversion and NOT trespass – no good answer for why this is the case – Rowbatham in *Stewart* sees a stronger role for trespass because working mine without being able to be there
            - OilCo took Lady F's gas so have committed this tort
            - This is an odd approach
        - Uses milder approach, looking hypothetically at what would have been a reasonable negotiated approach given the knowledge held by the parties at the time
        - Court bases its reasoning on **compensation** (lessor focused) rather than **restitution** (lessee focused)
    - **Freyberg tried to distinguish *Montreal Trust* but is not successful**
        - Tried to say that it is in a position, unlike a trust company, where it should be able to help development be realized individually
        - Court said no – there are too many institutional barriers to Lady F operating the well herself either personally or through a corporation, even with an experienced contractor to do the work
    - **Interesting "negotiation" imagined by the court**
        - Evidence of highly productive wells on neighboring property. F knew she had a **productive well** and would walk into negotiations with this info in hand, so would not be enticed to accept the same royalty rate because she knew she could leverage that negotiation with other oil companies
        - Oil Co would have the well license and access to surface lease – defendants could not argue that F would only be entitled to the industry standard about because the **absence of the element of risk here**
        - **Flexibility** shown by the court – even in the milder approach
- Holding:
    - OilCo committed the tort of conversion because they took Lady F's gas
    - 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
- Ratio:
    - In calculating damages on the compensatory basis, must look at whether the applicant could have produced the substances themselves, or would have required 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 the 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 (no risk component)

***Stewart Estate v TAQA North* (2015 ABCA)**

*<u>Trespass and conversion</u> are the right causes of action; leading case in AB but **different than Sask**; supports mild rule as fair and just determined by net operating income; closes the door on the harsh approach*

- Facts:
  - 5 freehold PNG leases were executed in the 1960s, each 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 wasn't started again in 90 days = termination)
  - A third proviso stated that if production ceased due to "lack of or intermittent market" or reasons "beyond the lessee's reasonable control", the cessation in production would not count towards the 90-day period
  - In 1995 production ceased on all properties and didn't restart until 2001
  - Three were found invalid because they were capped due to abandonment and not lack of market. One was granted a license for reworking
  - Trial: used the mild compensatory approach to damages of royalty plus bonus
    - Note: this is what we saw in *Wildcatters* and *Freyberg* – to award more to the plaintiff would be an unjustifiable bump
- Issues:
  - Did the lease terminate in 1995, 2000, or not at all?
  - What was the cause of action? What damages should be allowed?
- Reasons:
  - **Did the leases terminate?**
    - Rowbotham JA:
      - Held that the leases had terminated in 2000 because this 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
      - **Test applied:** relevant test is whether, based on information available at the time, a prudent lessee would have foreseen profitability from the wells in question (*Freyberg*)
        - Once profitability became reasonably foreseeable – had 90 days to resume working
      - **Allowed a right of action under both trespass and conversion**
    - McDonald JA & O'Farrell JA:
      - Found that all five leases had terminated in 1995
      - Under the terms of the lease, the third proviso could only apply 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 five years and ceased production
      - BUT the surrounding gas fields continued to produce and sell – so the reason for the cessation in production was the well's lack of economic viability (lessee's conduct) and <u>not</u> the lack of or an intermitted market
      - Proviso 3 was not applicable and the lease was terminated
  - **Cause of action/damages**
    - 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 terminated
    - Rowbotham J:
      - Looks to the principles of *Sohio*
        - The SCC looked for an "equitable and just" remedy for factual circumstances
      - Problems with the royalty method
        - Allows the lessee to benefit from the resources 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 o/g resources themselves
          - Suggests this underemphasizes property ownership
        - Ignores resource ownership and might encourage a lessee to continue production under a lease that has been challenged because the consequences are not severe
      - Harsh rule analysis
        - Should only be permitted in <u>extraordinary circumstances</u>
        - Argues that *Sohio* allowed for something less than 100% disgorgement (30% of net proceeds)
          - Questions the availability of the harsh rule and that such a 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 (harsh rule essentially) should **no longer be available to remedy a trespass of this nature**
        - Harsh rule should be **abandoned** unless the trespasser's conduct warrants punitive damages
    - Mild rule analysis
        - This is 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: **net operating income**
            - Proceeds minus the reasonable costs of production, transport and marketing
    - Date after net proceeds provided
        - Will vary based 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 with the lessor, which coincided with the point where the lessor was able to recover their costs
- **Application of *Sohio***
    - Rowbotham:
        - Says *Sohio* reflects the mild rule
        - Neither the royalty approach nor harsh rule are consonant with *Sohio*
    - McDonald:
        - Says harsh rule is available (and on facts where Rowbotham said it wasn't) – lack of clarity and uncertainty
        - Harsh rule even though there was good faith by lessee
        - Harsh rule consistent with *Sohio*
    - O'Farrell:
        - Ultimately endorses Rowbotham's approach

- Ratio:
    - Action can be made by the lessor in either trespass or conversion
    - Approach to damages: mild rule unless the lessee engages in conduct warranting punishment (very rare)
        - Determined by net operating income – proceeds from when the well was invalid minus reasonable costs for lessee
    - State of the law slightly unclear
        - Rowbotham had to read in a lot to *Sohio*
    - Date after which net proceeds will be provided to lessor
        - **Depends on what is fair and equitable in allowing lessee to cover their costs,** but generally is the date of lease invalidity
- Theory behind the remedy:
    - Harsh rule is full restitution/disgorgement
    - Royalty approach is all about compensation – putting plaintiff in reasonable position they would be in if the wrong did not happen
    - Mild rule #1 is about restitution – righting the rule of trespass and giving the lessor what is theirs
        - But there is an element of **compensation** here too – blurred line here between compensatory and restitutionary
        - Compensating the lessor for the value of their property
        - The substances removed are gone so shouldn't this value go to the lessor?

Best way to think about damages – there are competing authorities

- *Wildcatters* in Sask gives precedent for that jurisdiction, favours "milder" approach (royalty + bonus)
    - We also see this in *Freyberg* (milder approach)
    - Both cases concerned about giving lessor a "bump" in compensation
    - Analyzed within the British inherited approach which seems to struggle between restitutionary-style damages and compensatory-style damages
    - According to these, both harsh and mild #1 sound in restitutionary-style damages
    - Milder approach sounds more like regular, tortious, compensatory damages
- Distinguish – if you are a sophisticated lessor capable of producing on your own that also maintained its own portfolio of land it didn't work, and you were aggrieved
    - Could argue you deserve milder damages because you could work the land yourself

- In *Stewart* – gets the bare majority
    - Says that "mild" (previously construed as partial disgorgement, restitution) is the right approach generally because it does a better job valuing property interest
    - Accounts for the fact that people's property rights were violated in a way that mild doesn't
    - Less worried about overcompensation flowing to lessor, more worried about lessee getting away with this action just with a slap on the wrist
        - See this theme in surface access cases too – o/g cases not dissuaded from acting in a certain way
    - Under proper compensatory approaches to tortious damage awards, we should focus more on the mild approach
    - Harsh rule is something we don't need because punitive damages are always available if there is high-handed conduct
        - Could use if they were acting intentionally and egregiously
    - Her approach doesn't get the best weight because other judges would open the door back to harsh
    - Leaves us with an unsatisfactory precedent for AB

***Xerex Exploration v Petro-Canada* (2005 ABCA)**

Conversion & misrepresentation case; compensatory damages approach – putting wronged party back where they would have been

- Facts:
    - Abt is the sole shareholder of Xerex. Petro-Canada owned the shallow rights and Xerex owned the deep rights
    - Abt discovered that another company was producing oil from a well that Xerex owned a 3% gross overriding royalty in; Xerex had never received any money from that well
        - Abt did not know that Petro-Canada had already drilled a well into Xerex's deep formation and knew how profitable it would be (kept the info hidden from Xerex in their negotiations)
        - When Petro 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
    - Trial court: found Petro liable in trespass, conversion and misrepresentation
        - Awarded Xerex $8,133,000 for the misrep
- Issue:
    - Did Petro have a duty to disclose its findings in regard to the quality of the well to Abt when it purchased the full license?
    - What damages should be awarded?
- Reasons:
    - **What is a GORR?**
        - Gives the holder a percentage of the proceeds from the well
        - It is "overriding" because it is carved out of the lessee's royalty
        - It is unconnected to the mineral ownership – stems from the lessee's interest, not the lessor's
        - Lessee pays the GORR in addition to the royalty it pays the lessor for the right to work the substance
    - **Fiduciary relationship – Petro had a duty to disclose**
        - The circumstances of this case put Petro in the position of a fiduciary
            - Trespass and gain of knowledge of the deep rights placed Xerex in a very vulnerable position
            - This imposed a duty to disclose findings
        - Petro had a duty to disclose to Xerex that (1) it had entered the deep rights and (2) what it discovered
    - **Court found liability on trespass and misrepresentation**
        - Petro made false misreps that it had not explored Xerex's formation even though they knew they had
            - Xerex speficially asked Petro if they had, and Petro said "no"
        - Also a trespass because Petro drilled into the deep well without the right to
    - **Damages**
        - Compensatory in scope and founded primarily on the misrep
        - Damages should reflect the amount that would be restored to Xerex if the property was returned
            - Xerex would have negotiated a 50% farmout arrangement if it had known the quality of the well (wouldn't have retained a 100% interest)
            - So Xerex was entitled to 50$ of the value of the mineral interest as of the date of trial
        - Xerex would not have agreed to retain only a 3% ORR if it had known the extent of the reserves under the license
            - But also wouldn't have developed itself because it only had 13 days remaining on its license
        - Court uses approach similar to *Freyberg* – what would the negotiations have resulted in?
- Holding:
    - Trespass and misrep (no conversion found because there was an issue with the resource not yet being personalty)
- Ratio:
    - Where a party makes a material misrep to the other that induces the other party to sell its interests where it otherwise would not, the wronged party is entitled to all of the profits it would have received had it not sold the interest

***International Corona Resources Ltd v Lac Minerals Ltd* (1986 Ont; 1989 SCC)**
Remedies/accounting case to restore a just and fair solution; true owner must pay lessee back for improvements that would have been made anyways

- Facts:
  - Corona was a small mining company, Lac was a big mining company. There was a property that Corona was interested in and brought Lac in to get some advice about. Lac helped Corona to explore the site, then left. Corona intended based on this survey to purchase the property
  - Instead, Lac went forward and purchased the property on their own
  - Corona sued Lac seeking transfer of title based on the actions of Lac and seeks the return of profits, including all the infrastructure on the site without any deductions being made
  - Lac put considerable development into the property ($230M) – Corona wants this turned over with no compensation
  - Lac argued that when they transferred title they should be able to get the money that was spent upgrading back
- Issue:
  - What compensation should Lac receive for its costs of developing the property?
- Reasons:
  - **Law of Property Act – s 37**
    - Indicates that when a person who makes improvement 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
      - "Belief" – an honest and bona fide belief
      - Lac's testimony is that if held an honest belief it was the valid owner of the lands
  - **Court finds there was a breach of fiduciary duty – title transferred to Corona**
    - Goal is to put Corona back into the position it could have been in if the breach had not happened
    - Asked: if Corona was in the position to develop the mine before the breach, how much would they have to spend? What improvements did Lac make that should be discounted?
      - Lac spend $24M developing the mine, but the court held Corona had to pay Lac $50M to get the mine title
      - This is because Corona would have spent $50M themselves to develop the mine (they had operations closer to it so it would be cheaper for them than for Lac)
      - This $50M cost would have been spent by Corona, so it is fair they have to pay this and do not benefit from Lac spending
    - Lac loses title
- Holding:
  - Corona would have developed the lands differently had it gotten that property – have to overspend because of the need to develop independently
    - But Corona would be unjustly enriched because more infrastructure would have been needed to develop, and would have had to make an expenditure to develop
  - Corona must pay Lac the cost of 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
- 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 true owner in the position it would have occupied had there been no breach

***Republic Resource Ltd v Ballem* (1982 ABQB)**
Unjustly enriched lessor argument failed

- Facts:
  - Republic (lessee) farmed out an interest in its leasehold rights to Joffre in consideration of Joffre undertaking to drill on the leased property
  - The well was drilled near the end of the primary term and completed after the end of the primary term. After, NG was discovered, the well was prepared for production, and then capped for lack of a market
  - There had been an effort to deal with the *Kininmonth* problem in the continuous operations clause
    - So – the lease was dead and the lessor 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 that they made to the land (drilling the well) via unjust enrichment
    - Allege that defendants (Ballem – owned the substance) received an incontrovertible benefit
    - Contend that they honestly believed in the validity of the lease

- Issue:
    - If Republic and Joffe fail to have the lease restored, are they entitled to receive compensation for the well that is constructed?
- Reasons:
    - **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
    - **Here – the 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 they were to be paid for, has generally no right to recover from the recipient renumeration for the work done"
            - The defendant lessors (Ballem) had <u>no knowledge that the well had been drilled until it was completed</u> and made no demands of the plaintiff to drill
        - Since the well is not actually producing, it would be unfair to force Ballem to pay for a well they did not request
    - **No incontrovertible benefit – no unjust enrichment**
        - Merely a benefit that could not be ascertained at the current time
        - The existence of 13 other nearby capped wells of the plaintiff's casts doubt on whether there is any true benefit in knowing there is gas
    - **Can't overlook the fact that the plaintiff's were engaged in o/g development – *high risk business***
        - Plaintiff's never expected the defendant to pay if they drilled a dry hole or abandoned the well
        - Lessee's were assuming certain risks by commencing the well
        - No deception
- Holding:
    - Lessee had a capped well. No incontrovertible benefit despite the infrastructure because of the nature of the o/g business and the options available to the lessor
    - Helps us distinguish circumstances where we have **sophisticated o/g companies –** could argue that one party being left with a completed well is an incontrovertible benefit that accrues to the other party – but for more traditional lessor that logic is not as persuasive
- 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
    - If the wronged party did not request or otherwise solicit the construction of the improvements by the tortfeasor, they should not be required to pay for the improvements they didn't solicit

NOTE: possible to argue an <u>equitable lien</u>

- Could file a lien under the *LPA* if there was a lasting improvement made to the land (commonly see in construction scenarios)
- *Law of Property Act* s 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

<u>Summary</u>

[1] What tort to plead?

- Trespass (in property) v conversion (in chattel)
- It is questionable that the plaintiff has a sufficient possessory right to make out a case in conversion at the material time, but this 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 ***<u>compensatory</u>*** (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
- VERSUS as a mechanism for accounting of benefit gained by lessor at lessee's expense – influence here

[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 have hoped to be
- What do we do? Give them windfall under the mild approach or milder bonus + royalty approach
- 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?
- Remains an uncomfortable precedent because of the broad language and because it utilized a very specific mechanism for coming to an equitable remedy
- Questions about it as a precedent going forwards

Reasons why leases fail

- **Examples:**
    - Failure to commence drilling within the stipulated time (*PCP v Husky*)
    - Improper payment of delay rental (*Murdoch* – SIR)
    - Operations at the end of primary term (*Republic*)
    - Pooling (*Gunderson; Potapchuk*)
    - Shut in well clause (most common reason for modern lease failures)
    - Interruption or cessation of production (*Montreal Trust Co v Wildcatters*)
    - Improper royalty payment and non-response to notice of default
    - Improper survey; improper title; unexpected termination
- **Scenario 1 – lessee drills well, but lease expires without production (*Republic*)**
    - Lessee loses lease and received no compensation
    - Counterargument: lessor has received an incontrovertible benefit
- **Scenario 2 – lessee produces hydrocarbons after termination**
    - Harsh result: lessee pays all proceeds of production (*Paramount v Imperial* – bad faith trespasser)
    - Milder result: in the absence of bad faith, the lessee must account for the proceeds received after writ (*Weyburn*)
    - Or net proceeds (*Champlain*)
- **A (formerly) common rationalization**
    - In the case of good faith trespass the lessee accounts for production

6. THE ROYALTY CLAUSE

Overview

Why the royalty approach rather than simple on-time payments?

- Better alternative to lump-sum payments because of the nature of o/g development
    - High production costs: having to make a big payment before production wouldn't allow for efficient business
    - High risk and speculation: some risk gets distributed back on the lessor through the royalty approach
        - The risk the lessee is taking is that they have to sink capital costs to achieve production
        - Could end up with a dry well that doesn't produce
- Instead – these factors support payment of the monies recovered from complete future work
    - Get your payday as actual production is secured

Royalties qualify as a "security"

- Upshot being that they are tradeable as a financial interest
- Help people participate in other modes of business

O/g industry is dynamic and experiences a high rate of turnover, so how a royalty is characterized is important

- *Contractual right*
    - Enforceable between parties

    - Not registerable on 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 prefer the interest in land characterization
    - Because it will bind on future purchasers – this is advantageous
    - If it is a mere contractual right it might only be enforceable between the parties in that contract, and when the contract no longer exists one party could lose enforceability and interest
- Registrable upon title
    - Subject to fractional constraints – want something to continue with the property

Difference between oil and gas

- *Oil*
    - Commonly sold pre-refinement
    - The basic separation costs (i.e. water exclusion) are generally borne by the producer (but see ***Acanthus*** for minor exception for transportation deduction)
    - Some basic transportation deductions are commonly borne proportionately by lessor and lessee
- *Gas*
    - Often sold post-processing
    - Generally the lessee will try to pass along the costs of transportation and processing to the lessor
    - **Jumping pound formula:**
        - Tailgate price (at plant once processed) and subtract it from costs of transportation, treating and reasonable processing
        - This accounts for profit return on invested capital
        - So even though it says "on said lands" – additional steps need to be taken into account

- 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 the said lands?
        - Are you actually selling it at the well-head, or somewhere further down the production stream where processing has occurred?
    - "On the said lands": refers to the value of the substance had it been marketed right at the wellhead (when taken out of the ground)
        - For oil: this would only allow for costs in the deduction of transporting
        - For gas: interpreted differently because of the activities that have to take place for the gas before it is marketed (use jumping pound formula)

- **Problem:**
    - These calculations are not regulated – the lessee may be able to make unreasonable deductions for processing and the lessor likely will not be able to assess because of the power imbalance
    - This problem is addressed in the CAPL99 lease
        - Allows for deductions up to a certain point
        - States that the royalty shall not fall below x% (inserts protection for the lessor, baseline level)
    - Solution: can request statements to show what sort of deductions have been included
        - But usually don't have the expertise to assess and know if they were appropriate

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
    - Length is indicative of the power imbalance
    - Has all the resources and expertise
- Where the Crown is the lessor, it has the advantage of being able to set down in specific detail all of the appropriate deductions, rate sharing, etc.
- Royalties are periodically reviewed

Lessor's Royalty

- Fractional share of production paid on production revenues (or in kind)
    - In kind: would get a certain percentage of the product to do what you want (older way of getting a royalty)

    - Now: its 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
- Upshot: it **attaches to the mineral estate**
    - So it is easy to argue that it is an interest in land
    - Can be traded, registered on title, can be an encumbrance that will follow the land

Gross Overriding Royalty

- Rights granted out of the lessee's interest by the lessee
    - Payable *in addition* to the lessor's royalty
- Common in farm-out agreements and other lease assignments
    - E.g. scenario where the lessor has reserved to herself a 15% royalty, meaning the lessee gets the remaining 85%. Lessee might want to do other things with their interest to help development, e.g. a farm-out agreement
        - Lessee might need technical assistance and instead of paying those individuals in cash, they use equity they hold in their interest and create a GORR
        - Then giving other legal entities the right to a certain return on production
- A cost-free share of production carved out of the working interest
    - Overriding: because it is paid prior to the lessee realizing their financial return
    - **Lessors royalty vs GORR – important difference**
- Harder to qualify as an interest in land
    - Because it is attached to the lease and not the land itself
    - They are carving their right out of their percentage of production that is allowed to occur based on the lease instrument – one step removed from the mineral estate
        - Carved out of the *contractual arrangement* - key different
    - Become an **issue:** if they have created a mere contractual right that disappears, then the holder of the GORR might be out of luck for continued payment

Characterizing royalties as contractual interests or as interests in land

- (1) **Traditional approach:**
    - Look to the instrument in question and assess its meaning to determine whether there was a conveyance of an interest in land
    - Focus on the language of the instrument – was the language there?
    - ***Bensette; Emerald;*** majority in ***Sask Minerals v Keyes***

- (2) **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)
    - Broader, more purposive approach to the interpretation of the interest
    - ***Scurry Rainbow;*** to some extent in ***BMO v Dynex***

Gross vs net royalties

- (1) **Gross royalties –** *payor absorbs costs*
    - Calculate and pay the royalty on the gross amount of production/revenue from production
    - The royalty payor absorbs the costs of exploration/develop and production
    - Not as good for the lessee, but better for the lessor

- (2) **Net royalties** – *payor passes on costs*
    - Calculate and pay the royalty out on the net amount of production
        - I.e. what has been realized; the amount that accounts for the costs of exploration/production and development
    - Not as good for lessor, but better for lessee

Acanthus Resources v Cunningham **(1998 ABQB)**

"At the wellhead" = market price minus downstream costs borne by the lessee; lessee may be able to deduct some reasonable upstream costs from royalty

- Facts:
    - A (the lessee) had a lease for the oil from C (the lessor) that provided a royalty payment of 17% of the market value of the oil at the wellhead

- The lessee seeks judgment for "excess royalties", claims that they are able to deduct treating costs, and that they have overpaid the royalty by the value of the treating costs
    - Lease provided the lessee had to remit monthly an amount equal to the current market value <u>at the wellhead</u> on the date of delivery

- Issue:
    - What is the meaning of market value "at the wellhead"?
    - Can treating costs be deducted? (yes)
- Reasons:
    - **Lessors are only burdened with costs AFTER o/g has been brought to the surface**
        - Can include costs after the wellhead that are upstream of marketing
        - Based on the language "market value at the wellhead" the court argued that this should allow for reasonable expenditures between the substance being brought to the surface, and actual marketing
            - I.e. includes some upstream costs
    - No deductions for the cost of bringing substances to the surface
        - But there may be reasonable costs that could be incurred after the wellhead, but upstream of the sale that a lessee can deduct from royalty payment (such as transportation)
    - Here the party could not put forward any evidence on what the average expenditure was for water separation
        - Court goes through analysis to come to a determination of the amount
        - Ultimately there is an entitlement to deduct treating costs, but has not provided evidence as to what those costs are
- Holding:
    - Possible for a company to argue that language like "market value at the wellhead" can include something additional to transport costs because some of these substances are unique
- 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

***Canpar Holdings Ltd v Petrobank Energy & Resources Ltd* (2011 ABCA)**

As a matter of interpretation and use, royalty should be paid for fuel gas as well; used compensatory method

- Facts:
    - C (the lessor) leased certain lands to the lessee (Petro) 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 royalty should be calculated on net saleable gas (i.e. at the time that it reached 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 claim a disgorgement of profits earned by the lessee during the time the lease was void
- Issues:
    - Does the royalty clause require payment on fuel gas?
    - Is relief from forfeiture available?
- Reasons:
    - **Payment on fuel gas was required**
        - Court says there is nothing in the lease that would allow the lessee to take the gas and use it for this purpose
            - The intention is that all gas produced will make it to market
            - If the parties had required a different intention, they should have built in a provision in the lease
        - Royalties are an **obligation** – something legally required of the lessee
            - So since there was a breach of payment, there is a default provision to give a certain amount of time for the lessee to correct the default
    - **RFF is granted**
        - Court under equity has the power to grant FRR
            - It alleviates the burden of some of the damages that would be paid, and allows the instrument that appeared to have terminated to continue
            - **Judicature Act s 10**
        - As an equitable remedy it is discretionary and a high bar (SCC in ***Sask River Bungalows***)
        - Here RFF is granted and alleviates some of the harshness of the damages that would have been owing from lessee to lessor from operations under an invalid lease
            - Say the instrument can continue – no bad faith (felt they had a valid legal argument)
    - **Damages**

        - Instead of getting restitutionary damage, required to pay the differences owed to the lessor if the fuel gas had the royalty attached to it
        - Not entitled to full disgorgement of the profits, lease not void due to the pack of payment
            - The continued payment of the lower royalty value made a finding of disgorgement incorrect (not operating maliciously, etc.)
            - There was a huge disparity between the value of the property that would 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:
    - Royalties were payable on the fuel gas produced under the lease
    - RFF granted
- Ratio:
    - Royalties are payable on fuel gas depending on the words of the royalty clause
    - RFF may be granted based on three-part test to allow the lease to continue, even where royalties were not properly paid
        - (1) Conduct of appellant
        - (2) Gravity of the breaches
        - (3) Disparity between the value of the property forfeited and the damage caused by the breach
    - If you want to exempt fuel gas, best course of action is to have a **standalone** clause

CHAPTER 5: THE NATURE OF ROYALTIES

THE NATURE OF ROYALTIES

Keep in mind:

- Net vs gross
- Lessor's royalty vs gross overriding royalty
    - GORR: interest carved out of a profit a prendre (incorporeal hereditament)
    - Note: you can create an interest in land derived from an incorporeal hereditament
- Contractual interest vs interest in land
    - Test for characterization (traditional vs functional)
    - Important difference – interest in land can bind future purchasers; attaches to a percentage of minerals *in situ* or to a percentage of return on production
- Royalties qualify as a security
    - Means these are tradeable, registerable interests
    - See ss 1(x) & (xi) of the *Securities Act:*
        - 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

ROYALTIES IN GENERAL

Questions:

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

***Bensette v Reece* (1969 SKCA)**

Royalties retained by original landowner can be interests in land; can be registered on title

- Facts:
    - Burke, a private co, owned 36 quarter sections in Sask. Two of the SHs in Burke decided to withdraw from the land development
    - As their price for leaving they received a 6% royalty interest in those lands, which was protected by caveat

- Litigation ensued over whether they had a sufficient interest in land in order to file the caveat. The agreement itself read that the owner "doth, give, grant, bargain, sell, assign and transfer a 6% royalty in all **the minerals** which may be found in, under or upon the said lands

- Issue:
  - Was Bensette's royalty an interest in land or a mere contractual right? (yes)
- Reasons:
  - Whether something is an interest in lands depend on **(1) intention** and **(2) whether it can be an interest in land**
  - Did the grantor (Burke) even have an interest in land? Yes – he had a valid mineral estate so could transfer a fraction of his interest
  - Did he make a successful conveyance? Yes – taking the precise and unambiguous words used in their ordinary and natural meaning, Burke did intend to sell and transfer to Bensette a fractional 6% of its minerals in the lands
    - Court notes the words "royalty *in* the minerals connotes an interest in the minerals, but other forms of language may not lead to that inference
    - In obiter, suggested that "royalty *on*" would connote some kind of commission, which is not an interest in land and would be contractual
  - Was the caveat valid? **Yes – an interest in minerals is a property interest, and therefore a caveat can be filed which then makes it known and binding upon future purchasers (runs with the land)**
    - If the caveat is challenged, the caveator has to defend it – failure to do so means it is stricken from title
- Holding:
  - A lessor's royalty can be an interest in land. Used the words of the grant, and assigned an interest in minerals of the land
- Ratio:
  - A royalty can be an interest in the land if it shows intention
  - Seek clarity in drafting – be clear that what is being granted is a *"royalty interest in the minerals on the land"* and not some mere commission from speculative production from the lands
  - Turns on a technical reading of the language

Emerald Resources v Sterling Oil **(1969 ABSC)**

Look at the terms of the royalty agreement – does it appear to describe an interest in land? It is a matter of interpretation

- Facts:
  - Contractor hired at the rate of $1200/month plus an overriding royalty of 0.5% on properties on which the employer should acquire an overriding royalty
  - The royalty was not to be assigned to the contractor immediately – was to be granted if he had not resigned or been terminated after a year, and would apply to all projects consummated in the first 6 months – effectively the contractor received a 6-month delay in assignment of royalty only on consummated deals
  - Emerald alleges that the appellant breached its contract when it terminated the contract without cause or notice – appellant says the royalty agreement was never reduced to writing, and since it is an interest in land it is invalid
- Issue:
  - Should Emerald be entitled to an overriding royalty interest in the lands?
- Reasons:
  - 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 terminate with cause)
  - Considers whether it would be available to the plaintiff to claim an interest in land
    - Court **casts doubt on this –** says it is **"doubtful whether such a royalty that existed in this circumstance would ever qualify to be an interest in land"**
    - NOTE: this case is *not talking about a lessee creating a GORR*, this is a person already subject to a GORR *creating another one*
    - This interjection of additional relationships seems to sever the connectivity – unique situation
  - 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
    - 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
    - = contractual interest
- Holding:
  - Emerald was entitled to one half of the 1% GORR interest in projects *consummated* (o/g was discovered) during Emerald's contract
- Ratio:
  - The nature of a royalty interest is determined by the construction of the granting decide
  - If the royalty only becomes operative after the substances have been severed from the realty and brought to the surface = not considered interests in land

***Saskatchewan Minerals v Keyes* (1972 SCC)**
Majority says royalty is not an interest because of language; Laskin dissent calls it an interest in land – FUNCTIONAL APPROACH – new era of royalty agreement interpretation (look at intentions of parties; rebuttable presumption)

- Facts:
  - Astral had two leases to Sask salt mines. Astral acquired the leases from a person who didn't actually own those leases but had an option to buy them
  - When they acquired the leases, they granted to the vendor of the option 87,000 shares plus "a royalty of $0.25 per tonne on all salt produced and sold from the said leasehold property"
  - Lease/land were not covered by land titles. Sask Co buys the Astral leases
  - Complex facts but basically: the respondent held an option to take over a lease for the salt reserves and Keyes agreed to transfer the option which carved out a royalty interest
- Issue:
  - Was the royalty granted an interest in land?
- Reasons:
  - Majority:
    - Not persuaded that it was more than a contractual agreement for a payment – endorses a traditional approach
    - Deals with it by saying that any interest it created was rendered void by failing to secure Ministerial consents; thus, only enforceable against Astral as a contractual right
    - If you want to create an interest in land through a contractual arrangement, the language has to be clear that what you are attaching that interest to is a mineral *in situ* (requires very specific language) – language of intention starting to creep in
  - Dissent (Laskin J): ushers in a **functional approach** that focuses heavily on the **intention of the parties**
    - Do not focus on small differences in wording
    - Says this isn't much different than surface rent for agricultural land where the rent is paid per acre or as a percentage of money earned off the crop that is produced
      - If a rent can be an interest in land, so should a mineral royalty (this is also an incorporeal hereditament)
    - Functional approach creates a **rebuttable presumption** that a royalty **is an interest in land unless there is clear language suggesting that presumption is rebutted** (only meant to be a contractual right)
    - Focuses more on the function and nature of a royalty, rather than its base characterization as an incorporeal hereditament
    - For this case – did not bar the creation of an interest in land
- Ratio:
  - Not every reservation or grant of a royalty creates an interest in land, but it *can be an interest in land* (language matters)
  - Start of the functional approach – start with a rebuttable presumption that a royalty is an interest in land

ROYALTY TRUST AGREEMENTS (RTAS)

Overview

- Common through the 1940s and 1950s in a burgeoning AB o/g market where farmers considered weighed options in dealing with uncertain returns on prospective oil and gas development
- RTA: farmers transfer their lessor royalty interest to a trust company in return for fractional trust certificates
  - Way to hedge your bets – spread your interest out amongst many plots to get some part of a reward
  - Analogous to a security/share in a company
  - History described in ***Guaranty Trust v Hetherington***
- Process:
  - Basically: trust companies register and caveat their interests and the famers then traded or otherwise disposed of their returns
    - Break down the then common 12 ½ per cent lessor's royalty into fractional interests so as to facilitate dealing with the royalty interest by way of sale, trade or gift (***Guaranty***)
  - Everyone transfers lessor interest to a trust company and get, e.g. 10 certificate in returns
  - Trust co's pool development but if one of the lands gets developed, likely that before this people had traded their certificates
  - So no one would get the ultimate 10%, but each would get dividends for the certificates they held on that property = limit ultimate return but spread out risk
- Note: different approaches in AB and Sask

- Sask approach: groups of individuals who owned mineral rights sometimes chose to place those rights in a mutual company in exchange for shares of the company. That company could then choose to lease the lands that they owned and, if any lessee struck oil, all the shareholders would benefit (***Landowners Mutual***)
    - The SHs in mutual companies thus held multiple lottery tickets, although those tickets entitled them only to a small portion of any "prize" that was ultimately won by successful production on company lands

Guaranty Trust v Hetherington **(1989 ABCA)**

RTA here gave contractual right, not an interest in land; RTA not carved out of the 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
    - In return for a 12.5% royalty payment, Alden 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, Alden entered into separate gross royalty trust agreements with Prudential 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 is the successor in title to Alden – in consideration for a gross royalty, they 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
    - TJ: 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
- Issue:
    - Is an RTA an interest in land that is registerable on title and binding on successors in title?
        - This question goes unanswered – CA only focuses on whether the RTA only cover royalties under the original Bravo (elapsed) leases or if it extended to cover current (productive) leases
- Reasons:
    - Court favoured a traditional approach to interpreting royalties; focused on the language of the agreement itself
        - Concludes that the interest created relates to production off of the working interest and does not attach to the minerals themselves
        - The RTA was clearly **fashioned to only apply to the Rio Brave lease** – the trust agreement was drafted to be coextensive with this lease
        - For this reason it does not attach to the land and is not binding on successor leases
    - Court of appeal did not address the larger issue at stake – whether a royalty trust agreement creates an interest in land
        - Instead decided this case on the basis of **clause 25 and 2 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"
        - The lease <u>expired, it was not "cancelled"</u> so it was held that the royalty trust did not transfer to any new leases formed subsequently; royalty agreement did not continue after the lease expired
        - Language did not indicate an intention to assign an undivided fractional interest or an intention to assign an interest in the mines and minerals in place
- Holding:
    - 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/restricted by the original agreement
- Ratio:
    - Unsatisfactory resolution that led to additional test case resolution – left open the larger question about the nature of GORR
    - 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

***Scurry Rainbow v Galloway Estate* (1994 ABCA)**

RTAs found to be interest in land; FUNCTIONAL APPROACH used from Laskin's dissent in Keyes

- Facts:
  - This case involves the question of whether royalty interest 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 weak
  - The wording of one royalty trust agreement was identical to the wording in ***Guaranty Trust*** (referencing the specific lease on which the royalty was 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? Will they create interest in land, if at all?
- Reasons:
  - **Return to Laskin's functional approach**
    - (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 trusts, and concludes that the lessees in question did have to pay
  - **(1) Is the lessor's royalty under the o/g lease an interest in land?**
    - The lessor's royalties are unquestionably an "interest in land" as they apply to the PNG lease themselves
  - **(2) What about the royalty assigned to a trust company?**
    - The court looked to the language used in the trust agreement to interpret the intent of the parties in the royalty trust agreement
      - The ***Guaranty*** clause used specific words that are typically used to indicate a conveyance of land interest (i.e. grant, bargain, sell, assign, transfer, right, title, interests, both in law and equity)
      - This is a broad-ranging clause that suggests a higher interest was being transferred, and not just a temporary contractual arrangement
    - The royalty trust agreement refers to taking 12.5% of the substances <u>produced</u> – nothing indicates that it was to be taken only as cash
- Ratio:
  - (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* (does not create a perpetuities problem)
  - (3) The initial PNG lease is correctly categorized as a grant of a profit a prendre to the lease, 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
  - NOTE: this construction accords with ***Berkheiser*** and American decisions
    - The concept that royalty reserved to a lessor in an o/g lease is considered to be real property is commonly accepted in American courts

<u>State of the law (Pre-*BMO v Dynex*)</u>

- ***Guaranty:***
  - TJ applied Martland J's traditional approach in *Keyes* and said that RTAs did not create an interest in land
  - CA avoided the issue and determined the case on the basis of a cancellation clause
- ***Scurry:***
  - TJ applied Laskin's dissent from *Keyes* and found that RTAs were capable of creating an interest in land
  - CA affirmed the fact that the lessor's royalty held valid property interests, <u>yet did not comment on whether the RTA effectively created an interest in land</u> (so no general rule)
  - **It would appear that all RTAs are valid except for the types that have a cancellation provision such as in *Guaranty***
  - However – there is still uncertainty in this area – now we look at how the SCC addresses the issue in *Dynex*

***Bank of Montreal v Dynex Petroleum* (2002 SCC)**
Court recognized Laskin's approach in Keyes; subject to clear intention otherwise, it is an incorporeal hereditament that can generate an interest in land; remitted to trial so no strict dicta

- Facts:
  - Dynex acquired many o/g properties in Sask, all of which were subject to various caveated interests, many of which were GORRs
  - They went to BMO for financing, and BMO took security in all of the OG leases
  - In the 1990s Dynex became insolvent and BMO acquired all of their properties. BMO started to sell them off and attempted to do so free and clear of the GORRs. They claimed that the GORRs did not create an interest in real property, ad that they instead were only contractual interests
  - The GORR holders disputed this assertion
  - TJ: GORRs are invalid because at CL it is impossible to create a further interest in land out of an incorporeal hereditament (a profit a prendre is an IH)
- Issue:
  - Did the RTA create an interest in land?
- Reasons:
  - **Court recognizes that Laskin's approach overrules existing CL such that an incorporeal hereditament CAN create an interest in land (subject to clear intentions against)**
    - They endorse this dissent and bring it to majority position
    - Good example of the courts looking at o/g arrangements and finding sufficient uniqueness to come to a conclusion they feel is appropriate
  - An o/g lease is an interest in land (***Berkheiser***) – so if you hold an interest in land you can create another interest in land in the form of a royalty:
    - "A royalty which is an interest in land may be created from an IH such as a working interest or *profit a prendre*, if that is the intention of the parties"
    - If you have an interest in land, you can carve out another interest of land if you intend it
  - **But when remitted to trial for determination on whether an interest in land was created, trial court takes us right back to the traditional approach to determine that no interest in land had been created**
    - Cognizant of the CA's warning not to "search for some magic words", but then does just that
    - Couldn't find intention on the language – bad application of SCC's preferred approach, TJ seems to prefer the traditional approach
- Ratio:
  - **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 GORR **can** create an interest in land
    - Upshot: attach royalties to the mines and minerals or at least the working interest in them; **be clear in intention**

State of the law after *Dynex*
- A royalty interest or GORR **could** create an interest in land
- When drafting a royalty agreement – avoid interest in petroleum substances saved, produced and sold
  - Safest thing is to make sure that the GORR attaches to a portion of the *working interest*
  - Avoid referencing only revenue or compensation – make explicit reference to mines and minerals / working interest

***Third Eye Capital v Dianor Resources Inc* (2018 ONCA)**
Confirming approach in Dynex; persuasive but not binding in AB

- 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 GORR 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 GORRs run with the land? (yes)
- Reasons:
  - Clause 4.1 explicitly states that it was the intention of the parties that the GOR constitute a covenant and an interest in land running with the property, and all succession thereof or leases which may replace them
  - Was also registered as on title as a caveat
  - Court acknowledges SCC decision in ***Dynex*** and summarizes the important aspects of what might qualify as an interest in land
  - Concludes that a GORR is an interest in land that can run with the land

- Ratio: persuasive (not binding) judgment that a GORR is an interest in land

Main takeaways
- Two different approaches to qualifying an interest in land in connection with the lease
    - (1) Traditional approach – strictly interpret the words of the contract
    - (2) Functional approach
        - As cases move along we see a trend of this approach being endorsed
        - ***Third Eye*** seems to confirm what the SCC held in ***Dynex*** (Laskin's dissent in ***Keyes***)
        - Need clear intention (clear language) to rebut the presumption of a royalty being an interest in land

CHAPTER 6: CROWN DISPOSITIONS

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

Common Approach
- O/g 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 resource
- Timelines:
    - Pre-1962: 21-year leases were common (entice exploration)
    - 1962-1976: 10-year leases (realize gains)
    - 1976-present: 5-year leases (enhance gains)
- Overall: shift towards shorter leases to help the government realize the gain, then more recently the 5-year leases with enhanced gains

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 (issued by AB Energy)
    - (2) **Leases:** for development purposes (looks similar to leases we've seen in freehold scenario), in areas you already know have resources
- Clauses common to both:
    - Granting clause
    - 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 reserved to 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
    - Land rights
        - **No warranty of title** (***Champlain*** 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
    - 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 is authorized to dispose of petroleum and natural gas leases and licenses:**

- **(1) On application**, if the Minister considers the issuance of the agreement warranted in the circumstances
  - A discretionary ability to issue l&l
- **(2) By way of sale by public tender** conducted in a manner determined by the Minister
  - Government maintains a public registry of properties/tracts of land becoming available for tender, and companies can bid on the rights for a license or lease in the area
  - Predominant way o/g leases are obtained
  - Done on a rolling basis
  - Lands available depend on where development is currently occurring
- **(3)** Pursuant to **any other procedure** determined by the Minister

Question: how does this interact with the role of the AER?

- Does not affect it substantially because AB Energy is engaging in dispositions of land, and the AER as regulator then is controlling what sorts of processes are allowed on the land
- Complimentary role – like the AER was setting conditions for licenses, safety, environmental regulations, this is still applicable in the scenario of Crown licenses and leases

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 PNG 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"
  - How much land and where it is will vary based on the *market, government priorities, and other factors*
- The Crown attaches expectations to licenses and leases:
  - Annual rent of $3.50/hectare must be paid for the area covered by the agreement
  - Tenure holders must meet all regulatory requirements
  - 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 its term (called "lease continuation"
    - Vs in freehold scenario where it is called primary and secondary term
    - Crown = we call it a "lease term" which gets "continued"

Petroleum and Natural Gas Tenure Regulation

- S. 1(i): "license" defined – for *exploratory* purposes
- S. 1(j): "lease" defined – for *development* purposes
- Provinces broke into regions – plains, northern, foothills
  - Region designation is important for initial term and maximum area designations
  - Defined in Schedule 1 to the *PNGTR*
- Designations are important for a license because in the disposition there is a depth requirement and a land size requirement for validation of the well that is drilled
  - It gives different allocations for initial term length, maximum area designations, and some subsequent decisions made on the land post-validation of the well
  - Overall: **areas are treated differently based on conditions of development**

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 = 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, drill)**
  - "Validation" must be done during this initial term
  - Generally demonstrate to the Minister that the land set aside for exploration *does* contain o/g potential
  - This is your base obligation as a lessee under a license – within 5 years or the initial term, have to evaluate the land and validate the presence of o/g
- **(3) Validating wells (usually individually or grouped) are to be approved by the Minister**
  - Can validate either individually or by group

    - **Validating well:** a well drilled to a certain depth in the initial term
    - **Grouping well:** by drilling one well you can validate your license on adjacent lands
        - Can validate one and claim from nature of reserve another license in the area is similarly validated
- **(4) If validated, apply for 5-year "immediate" term under s 11 (exclusive right to secure production from that land)**
    - Prescription of approved immediate 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 immediate term
- **(5) If selected lands prove to be "productive" or "producing" (as defined) then the license term continues indefinitely, like a lease**
    - Lease remains valid as long as production is continued

Note: additional step
- A license is generally issued where there is <u>less known o/g production</u>
    - Initial term for exploration
    - If exploration is validated, transitions to next term that functions similarly to a secondary term
- Gov't saying, come do the work of exploration for us, if it proves production then your license transitions into an analogous lease instrument

<u>Lease process from part 2 of the *PNGTR*</u>
- (1) as per s 81(1) of the MMA, the primary term for a lease with the Crown is 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*)
    - Important – different than freehold scenario
    - During transition from primary to secondary, there is <u>no requirement that the lessee demonstrate to the lessor that they have a productive well</u>
    - Here, to continue the lease there **needs to be formal Ministerial approval** and review of the state of production (additional to freehold scenario)
- (4) continuation can occur as a result of:
    - (i) production/productivity or related areas; or
    - (ii) based on the drilling of a "qualifying well"

<u>Takeaways:</u>
- What to know:
    - There is a two-tier system – license and lease
    - Public auction process for distributing these instruments
    - License and lease have characteristics that differ
        - License: the goal of exploration that is geographically influenced; validation into immediate term and eventually maybe productivity
        - Lease: looks more like freehold scenario, with added step of Ministerial approval at the end of the primary term for continuation

ASPECTS OF LEASES/LICENSES

[1] Continuation

***Industrial Coal & Mineral Ltd v Alberta* (1977 ABSC)**
Abandoned well property of the Crown, lease expired because Crown didn't respond quickly; lease declared valid to allow lessee to comply with continuation terms
- Facts:
    - Applicant was a transferee of a PNG lease from the Crown that was for a term of 10 years, transferred by Mesa Petroleum
    - There was an abandoned oil well on the lands from the previous lessee but the lease didn't refer to the abandoned well – was abandoned 10 years prior to Mesa entering into the current lease of dispute
    - At the end of the term the lessee asked to get the lease extended by using s 126(1) of the MMA, which allows the term to be extended if there is a producing well on the lands – was denied
    - No improvements were made to the well during the primary term; Crown contends this is required for that well to properly extend the lease and that the abandoned well wasn't in contemplation of the original lease to begin with
    - Applicant advances two 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 quantities (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 lease?
    - Can a Crown lease be extended by the presence of an abandoned, non-producing well on the lands?
- Reasons:
    - Trial court:
        - The lease did not pass rights to the abandoned well because it didn't turn its attention to that infrastructure
        - But, the Crown failed to respond to the Applicant's contention that it qualified to lease continuation of the abandoned well, so the Crown's correspondence didn't qualify as notice of lease termination saved only by the drilling of a new well – the Crown failed to afford the Applicant reasonable notice upon which to respond
        - Overall: the court found a way to save the lease even though the abandoned well didn't pass
    - ABCA:
        - 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 received in this context
            - Made the decision that the well was not a "producing well" within the meaning of the Mines and Minerals Act
            - This decision was reasonable based on the evidence
        - 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
            - Court notes that the lessee had indicated its intention to drill a new well the year before so the lessee wasn't misled to rely on responses from the Minister to determine how to continue the lease
            - Insufficient evidence on the record to show that the Crown failed to discharge its duties
- Holding:
    - Appeal allowed; lease is expired and invalid
    - Basically: sloppy lessee runs out of time and doesn't do what they said they were going to, tried to rely on Crown correspondence to save their lease – court said no, not enough detail
- Ratio:
    - TJ's 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
    - Example of the sort of issue that can arise under statute interpretation with Ministerial discretion

[2] 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*
    - Development at one level, and the other right revert to the Crown so the Crown can issue a new lease on these areas

[3] Default, Cure and Reinstatement

***Mines and 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 its just a matter of time
    - E.g. could have a 5-year lease that has expired, but if the Minister believes what the lessor is doing is sufficient on the land, they can unilaterally extend the term even after it expires (could give additional years to continue operations)
- **S. 8(1)(e):** Ministerial discretion to reinstate a surrendered or cancelled agreement if such action is in the public interest
    - Can go so far as to reinstate an agreement that has terminated or been cancelled for some reason if they believe it is in the public interest
- **S 45:** Minister's ability to cancel agreements if it is in the public interest to do so
    - E.g. if unsafe or hazardous, threatening other areas of o/g development
    - No cancellation in freehold scenario (only for violation of lease term) – but this power does not rest with ordinary lessor

- **Overall:** significant Ministerial discretion associated with these leases because it comes from statute, so more discretion to seal with leases and licenses than we would see with freehold agreements

Ongoing Royalty Discussion

- When is a good time for governments to increase the share of what the government is keeping / change in royalty scheme?
    - Usually during high returns and predictability for the industry – doesn't make sense to hit an industry struggling with a price collapse
- 2007 Amendment – *Our Fair Share* (+1.4 billion/year and industry push back)
- 2010/11 Amendment – rolled back many of the changes
- 2015/16 Modernization for new activity

CHAPTER 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
    - E.g. 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
- Solar: radiant heat and energy – passive (building location and design) and active (solar collection and photovoltaic cells)

Issues: surface development, not subsurface – harnessing things difficult for others to stake a claim in / ownership interest in

- E.g. sun is readily available to everyone

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 certain portion of fit
    - Comes with a guaranteed return so long as the company remains 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 not sunny)
        - Localization – challenges adapting the grid to meet energy distribution and localized electrical demand
- **Potential profits**
    - Can take a variety of forms
    - Predominant form of profit return for landowners is a rent – unlike a royalty, a renewable energy company would enter into a rent-style agreement to give a certain payout on the land over time
    - Different than a royalty – here, the profit is derived from participating in a rent charge or some return on the electricity that has been developed
- **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 courts if there is a dispute
        - Everything happening is 100% voluntary, consent driven, and will not be under the same regulatory scrutiny
        - Regulation is not by the AER, but by the Alberta Utilities Commission
    - No government "orphan wells" programs for solar / wind farm projects in the event of insolvency
        - If an o/g operator goes bankrupt the fund will 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 far and your neighbor doesn't, there are two claims: (1) nuisances they have to incur and (2) the financial compensation you are receiving over them

        - Rule of capture doesn't really apply because it's not like your neighbour's solar farm is taking the solar energy that would otherwise be available to you
        - Benefit / detriment discussion instead of capture: who is gaining and who is left with the consequences?
            - As a landowner if you don't participate and your neighbour does, the neighbour can reap the benefits and you are stuck with the nuisances in return

Regulating Renewable Energy Development

- *Alberta Utilities Commission Act*
    - Extensive regulatory powers
    - S. 17(1) – public interest decision-making regarding AB's energy system
        - Under AUC Rule 007, this applies to renewable energy projects
        - Intervenor process for concerned individuals to raise their objections
        - Also applicable to private lands
    - General approach is to avoid native prairie grassland to prevent disruption, although this is possible on private land
    - Major way a lot of issues have come up is that during the administrative process of determining if a renewable project is in the public interest, neighbours participate as interveners
        - They look to lodge their concerns, which then becomes part of what the AUC has to consider during the decision-making process
        - They can also raise concerns through (1) the consultation process with the company (2) the municipal land approval process and (3) the AUC approval process
    - Also applicable to private lands, especially if they are of significance

AUC Application No. 1606143

- Background: Sec 9(2) of the AUC 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 the other parties to the application, and
        - (c) hold a hearing
    - Basically:
        - (1) There must be a direct adverse effect on you as a person or to your property
        - (2) If the Commission knows of this, they must give notice, avail themselves of the facts of the application, and hold a hearing
- Overall: this area is in the **administrative realm,** then potentially if the outcome is not what was anticipated by the company, then it can be appealed (or appealed for judicial review by a party that had standing)

Leasing Renewables

- **A renewable lease is very different than an o/g lease:**
    - In AB, there is no right of entry or expropriation process for a renewable energy power plant
    - Participation is 100% voluntary and you are under no obligation to entertain a proposal, contracts are negotiated bilaterally between the landowner and developer
        - But if you decline interest the developer may find a spot nearby, so you would experience the impacts without generating direct value from revenue
    - While power plants are voluntary, there may be a need for associated infrastructure – the *Surface Rights Act* process for right of entry applies to this, so your power plant could have other implication for you or your neighbours
    - There is no standard option to lease for solar and wind developments – proposals could vary significantly, so the landowner should make sure they get a good deal
- **Lease in renewable context is usually described as an option + lease**
    - **Option:**
        - Exclusive option to lease the described lands within 5-year option term
            - Period of time that exists before the lease formally comes into operation, which gives the lessee (power company) an exclusive period of time to explore the potential for power activity on the described lands
            - So if there is a 5-year option period, the company will pay a certain return (option fee) plus additional consideration, and during this period they will do testing
            - Certain return that is generated for the lessor for that period (similar to a primary term, but instead of moving towards production it is an option to trigger the lease
        - $1000 "option fee" + "$1000 "additional consideration" for nuisances/inconveniences each anniversary date

        - Minimal fees to pay
    - Option can be exercised by writing
    - Automatic termination of the option at the expiry of the 5 years, with 90 days for full removal of any infrastructure on the land
        - Likely to occur if the company determines it is not a profitable endeavour
- **Lease**
    - Effective from the date of receipt of notice
        - If the option is exercised and the parties decide to enter into the lease, the lease is effective from the date of notice
        - Like an o/g lease, a lot of detail turns on what land is covered, what disruption is allowed, and what sort of primary term we're talking about (how long the lease will exist)
    - What is covered (clause 6)
        - Land description with particulars of the property
    - With renewal (clause 6)
        - Allows for a second primary term
    - For how long ("Primary term") (clause 6)
        - Usually a long term contract ranging from 20-60 years
        - Landowner may request a shorter period, but the developer may be reluctant to agree if the timeline is too short b/c they might not be able to earn back their investment
        - Remember: no standard contract
    - Lessee entitlement (clause 7)
        - What is the lessee allowed to do on the land? Maintenance activities? How much can they disrupt? What kind of infrastructure can they develop?
    - Payments
        - E.g. $500 per lease year per acre ("rent")
        - Paid quarterly
        - Can be paid based on "estimated rent" which is then adjusted within 30 days of year's end as "actual rent" (e.g. if there is inflation of adjustment that has to be made)
        - Can have rent adjustments in the 6th year, based on the prevailing Consumer Price Index (CPI)
            - Lessor can continue to make market value for their land as they anticipate it changing over time
- **Areas of contention**
    - Renewable energy is 100% voluntary – but if your neighbour opts for renewable development on their land and you don't, you can suffer some of the consequences without the corresponding benefits
        - Rule of capture doesn't apply
        - What does apply – wind/solar farm leading to nuisance and you don't get rent returns
    - There is no standard form lease, and the leases that companies currently use are generally drafted to satisfy the drafter's purpose
    - More surface land required for solar than wind
        - Greater physical footprint
    - Wind allows for concurrent use; solar doesn't
        - E.g. for solar, probably not farming around those parcels, dedicated land
    - Options to lease are typically 3-8 years
        - Keeping option period low is advantageous so the land isn't tied up in speculative purpose for lessor
    - Primary terms are commonly 20-60 years
        - Can be detrimental if you agree to a 60-year term and tie up the property
    - Lack of financial oversight & compensation forms
        - Different types of compensation packages, could try to tie compensation to profit of electricity ultimately generated
        - Risky because not guaranteed a return like you are per acre, but if highly productive could be very beneficial
    - Valuation over time
        - Unlike o/g development where the resource generally depreciates as it is expended and produced, we see a different trend for renewables – with fine-tuning and maintenance for solar and wind, they actually become *more profitable and efficient* as time passes
        - Might see early fluctuations in production, but as time passes may see farm that doesn't reach peak until 5, 10, 15 years, etc.

- Area to watch – lessor might agree to something that is standard rent charge, thinking that the lease is a certain type of production, but if they entered into something more fluctuating, could see better returns as it progresses